WHAT THE EURO CRISIS MEANS FOR TAXPAYERS AND THE U.S. ECONOMY, PART II

HEARING

BEFORE THE

SUBCOMMITTEE ON TARP, FINANCIAL SERVICES AND BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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WHAT THE EURO CRISIS MEANS FOR TAXPAYERS AND THE U.S. ECONOMY, PART II

FRIDAY, DECEMBER 16, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TARP, FINANCIAL SERVICES AND BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2154, Rayburn House Office Building, Hon. Patrick T. McHenry (chairman of the subcommittee) presiding.

Present: Representatives McHenry, Guinta, Gowdy, Quigley, Cummings, and Maloney.

Staff present: Molly Boyl, parliamentarian; Katelyn E. Christ, research analyst; Drew Colliatie, staff assistant; John Cuaderes, deputy staff director; Gwen D'Luzansky, assistant clerk; Adam P. Fromm, director of Member services and committee operations; Linda Good, chief clerk; Peter Hallor, senior counsel; Ryan M. Hambleton, professional staff member; Christopher Hixon, deputy chief counsel, oversight; Mark D. Marin, director of oversight; Rafael Maryahin, counsel; Jaron Bourke, minority director of administration; Devon Hill, minority staff assistant; Jennifer Hoffman, minority press secretary; Lucinda Lessley, minority policy director; Jason Powell and Steven Rangel, minority senior counsels; and Brian Quinn, minority counsel.

Mr. MCHENRY. The committee will come to order.

This is the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs.

Our hearing today is, "What the Euro Crisis Means for Taxpayers and the U.S. Economy." This is part 2 of a two-part hearing about the ongoing crisis that Europe is facing and the American people, the American citizens', as taxpayers, exposure to that.

It is the tradition of this subcommittee to begin with the Oversight and Government Reform Committee's mission statement.

We exist to secure two fundamental principles: First, Americans have a right to know that the money Washington takes from them is well spent. And, second, Americans deserve an efficient, effective government that works for them. Our duty on the Oversight and Government Reform Committee is to protect these rights.

Our solemn responsibility is to hold government accountable to taxpayers, because taxpayers have a right to know what they get from their government. We will work tirelessly, in partnership with citizen watchdogs, to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy.

This is the mission of the Oversight and Government Reform Committee.

I now recognize myself for 5 minutes for an opening statement.

Over 3 years ago, Americans witnessed domestic and global markets deteriorating, resulting in millions of job losses and unprecedented measures by governments and central banks to prop up financial institutions. As the U.S. economy remains vulnerable in the midst of a recovery, just across the Atlantic our friends in the European Union fight to fend off a second wave of economic and financial turmoil.

Today's hearing examines the economic unrest facing Europe, actions undertaken by central banks and international organizations in response, the options that remain at our disposal, and potential consequences to the U.S. economy and taxpayers.

During the onset of the 2008–2009 financial crisis, asset-backed securities, chiefly mortgage-backed securities, unexpectedly became illiquid and fell sharply in value, resulting in a housing bust—now, housing downturn, ended up with an asset crunch that ended up in a larger housing bust. Financial firms were forced to write down losses that depleted their capital base and reduced their access to private liquidity. In response, the U.S. Treasury, Federal Reserve, and U.S. Congress acted, well, in a way that the American people are very familiar with. They know this story.

Today, Europe's version of this story appears to be one of which sovereign debt plays the role of asset-backed securities. Some say history repeats itself; others say that it simply rhymes. This may be the case of history repeating itself or simply it feeling and it seeming like the last crisis or perhaps the European successor to what happened between World War I and World War II.

Europe's banks hold substantial amounts of European sovereign debt that has dropped in value as the debt of periphery countries has become unmanageable. Given the substantial amounts of sovereign debt on the books of European banks, their ability to borrow has been brought into question. Perhaps these European sovereigns are analogous to Freddie and Fannie preferred that many thrifts and small banks across this country held as Tier 1 capital.

The European twist to the story is that nations home to the most troubled banks do not have the financial capacity, perhaps, to bail them out. Austerity measures and maxed-out balance sheets of periphery countries, known as PIGS, have left the EU and its central banks scrambling to identify an intervention to end the panic and restore normalcy to the markets.

As time runs out for the EU, work—works to strengthen its framework in the European Central Bank, retains its dubious role as lender of last resort, a recurring financial savior inserting itself in the mix. The Federal Reserve and, to a lesser extent, the IMF are also providing this same notion.

Last month, in an effort to aid European banks that have trouble accessing dollars due to more scepticism about their health, six central banks, led by the Federal Reserve, made it cheaper for banks to borrow dollars to ease Europe's sovereign debt crisis. In the program's first month, there have been over $50 billion in transactions, prompting two immediate questions: Does the Fed action permit banks to get through the crisis without addressing their most toxic assets? And has the Fed averted a liquidity crisis or simply postponed an insolvency crisis?

Just yesterday, IMF Director Christine Lagarde said, “There is no economy in the world, whether low-income countries, emerging markets, middle-income countries, or super-advanced economies, that will be immune to the crisis that we see not only unfolding but escalating.” Director Lagarde’s remarks are troubling and remind us of the significance a financial meltdown has on the global economy. If events in Europe threaten U.S. banks and its economy, American policymakers must know the facts of the situation and be ready to act.

Despite differences of opinion about the Fed and U.S. Treasury actions, the reality is only a handful of individuals at each institution and department truly understand U.S. exposure to the eurozone crisis. Today’s oversight hearing allows the Federal Reserve Bank of New York, the Board of Governs of the Federal Reserve System, and the U.S. Treasury—all of which operate as our Nation’s foremost decisionmakers in the areas of economics and monetary policy—to communicate to Congress and to the American public about what is happening.

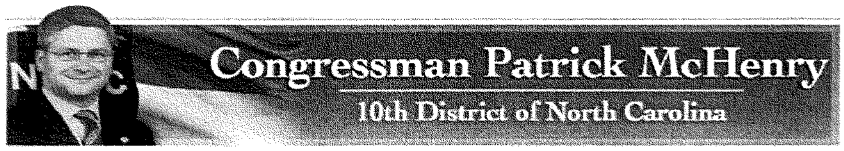
As daily headlines read of capital injections to the tune of billions and trillions of euros and dollars, reenforcing the interconnectedness of the global economy, it is vital that Congress conduct oversight on rescue proposals and threats to our economy. A simple question must be answered, a very simple question, such as: Are the actions of the Federal Reserve consistent with its mandate? And are the firms seeking liquidity simply illiquid or, perhaps, insolvent?

I am interested to hear from this panel and from each of you about your views on this eurozone crisis, current potential rescue efforts, and the consequences of the crisis on the United States—not just to the United States, but to our government; not just to our government, to our economy; not just to our economy, our citizens and taxpayers.

That is what this hearing is about. We don’t want to be caught flatfooted on what is happening in the global economy. And that is why policymakers on the Hill must know what potential actions you can take, how you view this crisis, and the actions that you have taken.

With that, I recognize the ranking member, the gentleman from Illinois, Mr. Quigley.

[The prepared statement of Hon. Patrick T. McHenry follows:]



Congressman Patrick McHenry
Opening Statement
"What the Euro Crisis Means for Taxpayers and the U.S. Economy"
December 16, 2011

Over three years ago, Americans witnessed domestic and global markets deteriorate, resulting in millions of job losses and unprecedented measures by governments and central banks to prop up financial institutions.

As the United States economy remains vulnerable in the midst of a recovery, just across the Atlantic, our friends in Europe fight to fend off a second wave of economic and financial turmoil.

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During the onset of the 2008/2009 financial crisis, asset-backed securities, chiefly mortgage backed securities, unexpectedly became illiquid and fell sharply in value, resulting in a housing bust.

Financial firms were forced to write down losses that depleted their capital base and reduced their access to private liquidity.

The response by the U.S. Treasury, Federal Reserve, and United States Congress is a story that is all too familiar to Americans.

Today, Europe's version of this story appears to be one in which sovereign debt plays the role of asset-backed securities.

Europe's banks hold substantial amounts of European-sovereign debt that has dropped in value as the debt of periphery countries has become unmanageable.

Given the substantial amount of sovereign debt on the books of European banks, their ability to borrow has been brought into question

The European twist to this story is that nations home to the most troubled banks do not have the financial capacity to bail them out.

Austerity measures and maxed-out balance sheets of periphery countries, known as PIIGS, have left the E.U. – and its central bank – scrambling to identify an intervention to end the panic and restore normalcy to markets.

As time runs out while the E.U. works to strengthen its framework, and the European Central Bank retains its dubious role as a lender of last resort, a reoccurring financial savior inserted itself in the mix: the Federal Reserve, and to a lesser extent, the IMF.

Last month, in an effort to aid European banks that have trouble accessing dollars due to market skepticism about their health, six central banks – led by the Federal Reserve – made it cheaper for banks to borrow dollars to ease Europe's sovereign-debt crisis.

In the program's first month, there have been over 50 Billion dollars in transactions – prompting two immediate questions:

Does Fed action permit banks to get through the crisis without addressing their most toxic assets?

And, has the Fed averted a liquidity crisis or simply postponed an insolvency crisis?

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Today's oversight hearing allows the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve System, and the United States Treasury, all of which operate as our nation's foremost decision-makers in the areas of economics and monetary policy, to communicate to Congress and the American public.

As daily headlines read of capital injections to the tune of Billions and Trillions of euros and dollars, reinforcing the interconnectedness of the global economy, it is vital that Congress conduct oversight on rescue proposals and threats to our economy. Simple questions must be answered – such as, "Are the actions of the Federal Reserve consistent with its mandate, and are the firms that seek liquidity simply illiquid or perhaps insolvent?"

I am interested to hear from each of you about your views on the eurozone, current and potential rescue efforts, and consequences the crisis may have on the United States economy and citizens.

I thank you for attending today's hearing and look forward to your testimony.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Yesterday, we heard from several nongovernmental witnesses with a shared concern of the euro debt crisis. There was a general agreement that a debt default in Europe would have a devastating consequence for U.S. taxpayers. As Mr. Elliott testified, we are exposed to nearly $5 trillion in potential losses on loans and commitments to European governments, banks, and corporations.

At the same time, yesterday's witnesses differed on the point of whether Europe can resolve this crisis with its own resources. Today, I look forward to hearing from our government witnesses, who can speak to their roles in resolving this crisis. We should be pushing Europe to act quickly and responsibly, but we cannot expose the U.S. taxpayer to potential losses.

Thank you. And I would like to yield the balance of my time to the ranking member of the full committee, Mr. Cummings.

Mr. CUMMINGS. Well, thank you, gentlemen, for yielding.

Mr. Chairman, thank you for calling the hearings yesterday and today on the financial crisis in Europe and its potential effects on the United States.

At yesterday's hearing, we heard that Europe faces two problems. One is a long-term budgetary problem that will require scaling back expenditures. The other is a much more imminent threat, that a major European country might default on its debt. It appears that European officials are paying close attention to the long-term problem at the expense of aggravating the acute crisis.

Yesterday, Desmond Lachman, an economist and policy expert with the American Enterprise Institute, testified as follows: "There is very real risk that continuing to apply substantial fiscal tightening will lead to a very deep economic recession. A deep recession would make it very difficult for countries to reduce their budget deficits and would undermine their political willingness to remain within the euro."

In 2008, when our own country faced the financial crisis, the Federal Reserve took action to prevent an immediate financial panic by acting as a lender of last resort. It did not insist that Congress first agree on how to slash the Federal deficit, cut the Federal work force, cut Medicare, and cut Social Security.

Although the actions taken in 2008 were not without controversy, the immediate financial crisis had to be averted. Long-term measures were left for the long term.

Unfortunately, perhaps dangerously, the European Central Bank is balking at functioning as lender of last resort. My concern is that this failure to act now could result in a deep recession in Europe or an insolvency of a major European bank, which could put our own economic recovery at risk.

Of course, our own recovery is not complete, by any measure. It is true that, after unprecedented assistance from the American taxpayers, corporate profits have returned to their highest level in years. Executives are making record salaries, and the richest Americans are continuing to see their incomes and wealth grow exponentially. Main Street, however, is struggling mightily. The unemployment rate continues to hover at 9 percent. Mortgage servicers continue to foreclose on millions of American families, many of them in my district. And banks have yet to be accountable for the abuses that caused this crisis.

For these reasons, I am glad that William Dudley, the president of the Federal Reserve Bank of New York, is testifying today. Just last month, he gave a speech at West Point in which he called on Congress and the administration to continue near-term fiscal support to underpin economic activity and long-term fiscal consolidation to ensure debt sustainability.

He also explained that addressing the housing crisis is essential to restoring the strength of our economy. Specifically, he called for "borrowers who are underwater on their loans but continue to make their monthly payments to earn accelerated principal reduction over time." He also called for more effective refinancing programs to "eliminate frictions and lower costs to refinancing for all borrowers with prime conforming loans." His message is directed to us in this Congress, and we should pay close attention to it.

Examining the European financial crisis is a very important endeavor. It is a real threat to European countries and to the United States. And I commend the chairman for holding these hearings.

It is my hope, however, that our committee will also focus on efforts to help Main Street USA and the millions of middle-class American families and workers who were the true victims of the financial crisis we face here at home.

And, with that, Mr. Chairman, I yield back.

[The prepared statement of Hon. Elijah E. Cummings follows:]

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States

House of Representatives

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Opening Statement
Ranking Member Elijah E. Cummings

Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs
Hearing on "What the Euro Crisis Means for
Taxpayers and the U.S. Economy, Part II"

December 16, 2011

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At yesterday's hearing, we heard that Europe faces two problems. One is a long term budgetary problem that will require scaling back expenditures. The other is the much more imminent threat that a major European country might default on its debt. It appears that European officials are paying close attention to the long term problem at the expense of aggravating the acute crisis.

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> There is the very real risk that continuing to apply substantial fiscal tightening will lead to a **very deep economic recession.** A deep recession would make it very difficult for countries to reduce their budget deficits and would undermine their political willingness to remain within the Euro.

In 2008, when our own country faced a financial crisis, the Federal Reserve took action to prevent an immediate financial panic by acting as a lender of last resort. It did <u>not</u> insist that Congress first agree on how to slash the federal deficit, cut the federal workforce, cut Medicare, and cut Social Security. Although the actions taken in 2008 were not without controversy, the immediate financial crisis had to be averted. Long term measures were left for the long term.

Unfortunately, and perhaps dangerously, the European Central Bank is balking at functioning as lender of last resort. My concern is that this failure to act now could result in a deep recession in Europe or the insolvency of a major European bank, which could put our own economic recovery at risk.

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Examining the European financial crisis is a very important endeavor. It is a real threat to European countries and to the United States, and I commend the Chairman for holding these hearings. It is my hope, however, that our Committee will also focus on efforts to help Main Street USA and the millions of middle-class American families and workers who were the true victims of the financial crisis we faced here at home.

Contact: Ashley Etienne, Communications Director, (202) 226-5181.

Mr. MCHENRY. Members have 7 days to submit opening statements for the record.

And we will now recognize our panel of witnesses.

Mr. William C. Dudley is the president and CEO of the Federal Reserve Bank of New York. Mr. Steven B. Kamin is the director of the Division of International Finance at the Board of Governors of the Federal Reserve System. Mr. Mark Sobel is the Deputy Assistant Secretary for International Monetary and Financial Policy at the U.S. Department of Treasury.

It is the policy of this committee that all witnesses be sworn before they testify. So if you will please rise and raise your right hands.

[Witnesses sworn.]

Mr. MCHENRY. You may be seated.

Let the record reflect that all witnesses answered in the affirmative.

And, with that, as you well know from congressional hearings, we have a light system. Green means go; red means stop; yellow means, well, just like a stoplight, hurry up.

So, with that, you will have 5 minutes to summarize your opening statements, and we will begin with you, Mr. Dudley.

STATEMENTS OF WILLIAM C. DUDLEY, PRESIDENT AND CEO, FEDERAL RESERVE BANK OF NEW YORK; STEVEN B. KAMIN, DIRECTOR, DIVISION OF INTERNATIONAL FINANCE, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; AND MARK SOBEL, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY AND FINANCIAL POLICY, U.S. DEPARTMENT OF TREASURY

STATEMENT OF WILLIAM C. DUDLEY

Mr. DUDLEY. Thank you. Chairman McHenry, Ranking Member Quigley, Congressman Cummings, and members of the subcommittee, it is an honor to testify before you today to discuss the economic and fiscal challenges facing Europe and the potential implications for the United States.

Let me preface these remarks by stating that the views expressed in my written and oral testimony are solely my own and do not represent the official views of the Federal Reserve Board or any other part of the Federal Reserve System.

Although the U.S. economy is currently expanding at a moderate pace, we face significant downside risks, mostly relating to the sovereign debt crisis in Europe. Because developments in Europe will have an important bearing on the prospects for growth and jobs here in the United States, the Federal Reserve is monitoring the situation there very closely. This is also why we have taken special steps, in cooperation with other central banks, to support the flow of credit to households and businesses. I welcome the opportunity to testify on these matters today.

The situation in the euro area is very unsettled, with pressure on sovereign debt markets and local banking systems. The euro area has the capacity, including the fiscal capacity, to overcome its challenges. However, the politics are very difficult.

Europe's leadership has affirmed its commitment to the European Union and its single-currency monetary union on numerous occasions, and leadership is working to achieve greater policy coordination in areas such as fiscal policies. Assuming that Europe ultimately succeeds in managing this situation, a stronger union will emerge that will be viewed as more robust and resilient.

If, in contrast, Europe were not to be fully successful in charting an effective course, this could have a number of negative implications for the United States. In particular, there are three possibilities that I would like to highlight for the subcommittee today.

First, if the European situation were to deteriorate, then the euro area would face even more serious fiscal and economic challenges. As a result, growth within the eurozone would weaken, and this would lead to less demand for U.S. goods and services that are exported to Europe from companies and workers here. It is important to recognize that the euro area is the world's second-largest economy after the United States and an important trading partner for us.

Second, if the European situation were to deteriorate, this could put pressure on the U.S. banking system. The good news is that the U.S. banks are much more robust and resilient than they were a few years ago. Also, the direct exposures of U.S. banks to the countries in Europe that are facing the most intense fiscal challenges are actually quite modest.

The bad news is that the exposures of the U.S. banks climb quite sharply when one also considers the exposures to the core European countries and to the overall European banking system. This means that if the crisis were to broaden further and intensify, this could put greater pressure on U.S. banks' capital and liquidity buffers.

Third, if the European situation were to deteriorate further, financial markets would likely become more stressed. This could tighten the availability of credit to U.S. households and businesses, and this could damage the U.S. recovery and result in slower economic growth and slower job creation.

In terms of the actions the official sector in the United States has taken or could take with regard to Europe, I want to emphasize that any and all such actions pursued by the Federal Reserve are motivated by the mandates that Congress has given the Federal Reserve to promote price stability and maximum sustainable employment here in the United States.

When the Federal Reserve was created by Congress in 1913, it was given the responsibility to provide liquidity to the financial system in times of stress in order to shield the economy, to the extent possible, from the severe effects of financial instability on economic activity and jobs. While the economy and the markets have evolved substantially in the century since then, this basic principle continues to guide our efforts today.

In today's globally integrated economy, banks headquartered outside the United States play an important role in providing credit and other financial services in the United States, providing a total of about $900 billion in overall financing within the United States. For these banks to provide U.S. dollar loans, they have to maintain access to U.S. dollar funding. At a time when it is already hardest for American families and firms to get the credit they had need, we have a strong interest in making sure that these banks can continue to be active in the U.S. dollar markets.

One way we can help to support the availability of dollar funding is by engaging in currency swaps with other central banks. This has been used as a policy tool dating back to 1962. Recently, the FOMC decided to use this tool, cooperating with five other central banks. This action is designed to support financial stability, avoid an unnecessary tightening in financial conditions, and support economic activity and jobs in the United States.

In particular, by reducing the cost of dollar funding by the swap lines last month, we reduced the pressure on banks in Europe to abruptly liquidate their U.S. dollar assets. Thus, this step will help to insulate U.S. markets from the pressures in Europe and support the availability of credit to U.S. households and businesses.

In sum, I am hopeful that Europe can effectively address its current challenges. The Federal Reserve is actively and carefully assessing the situation and the potential impact on the economy. We will continue to monitor the situation closely.

Thank you for your invitation to testify today, and I look forward to your questions.

[The prepared statement of Mr. Dudley follows:]

I. Introduction

Chairman McHenry, Ranking Member Quigley, other members of the Subcommittee, it is an honor to testify before you today to discuss the economic and fiscal challenges facing Europe and the potential implications for the United States. My name is Bill Dudley, and I am President of the Federal Reserve Bank of New York.

Let me preface these remarks by stating that the views expressed in my written and oral testimony are solely my own and do not represent official views of the Federal Reserve Board, the Federal Open Market Committee ("FOMC") or any other part of the Federal Reserve System. Additionally, because I am precluded by law from discussing confidential supervisory information, I will not be able to speak to the financial condition or regulatory treatment or rating of any individual financial institution.

The Federal Reserve seeks to promote financial stability in order to enable U.S. businesses and households to maintain their access to credit and to ensure sustained economic growth. Although the U.S. economy is currently expanding at a moderate pace, we face significant downside risks, mostly relating to the sovereign debt crisis in Europe. Because developments in Europe will have an important bearing on the prospects for growth and jobs here in the U.S., the Federal Reserve is monitoring the situation there closely. This is also why we have taken special steps, in cooperation with other central banks, to support the flow of credit to households and businesses. I welcome the opportunity to testify on these matters today.

II. Europe

Within the European Union, seventeen countries share a common currency, the euro. The situation in the euro area is very unsettled, with pressure on sovereign debt markets and local banking systems. The euro area has the capacity, including the fiscal capacity, to overcome its challenges. However, the politics are very difficult, both because the problem has many dimensions, and because many different countries and institutions in the euro area have to coordinate their actions in order to achieve a coherent and effective policy response.

Europe's leadership has affirmed its commitment to the European Union and its single currency monetary union on numerous occasions. And the leadership is working to achieve greater policy coordination in areas such as fiscal policy. Putting all the countries using the euro on a clearly sustainable fiscal path would help restore market confidence. Assuming that Europe ultimately succeeds in managing this situation, a stronger union will emerge that will be viewed as more robust and resilient. This would be a welcome development for the U.S.

If, in contrast, Europe were not to be fully successful in charting an effective course, this could have a number of negative implications for the U.S. In particular, there are three possibilities that I would like to highlight for the Subcommittee today.

First, if the European situation were to deteriorate, then the euro area would face even more serious fiscal and economic challenges. As a result, growth within the euro zone would weaken and this would lead to less demand for U.S. goods and services that are exported to Europe from companies and workers here. This would hurt growth here in the United States and would have a negative impact on U.S. jobs. It is important to recognize that the euro area is the world's second largest economy after the U.S. and an important trading partner for us. Also, Europe is a significant investor in the U.S. economy, and vice versa. Thus, what happens in Europe has significant implications for our economy.

Second, if the European situation were to deteriorate, this could put pressure on the U.S. banking system. The good news is that U.S. banks are much more robust and resilient than they were a few years ago. U.S. banks have bolstered their capital significantly, built up their loan loss reserves, and have significantly larger liquidity buffers. Also, the direct exposures of U.S. banks to the countries in Europe that are facing the most intense fiscal challenges are actually quite modest.

The bad news is that the exposures of the U.S. banks climb quite sharply when one also considers the exposures to the core European countries and to the overall European banking system. This means that if the crisis were to broaden further and intensify, this could put greater pressure on U.S. banks' capital and liquidity buffers.

Third, if the European situation were to deteriorate further, financial markets would likely become more stressed. This could tighten the availability of credit to U.S. households and businesses. It could also cause equity prices to fall and this would have a negative impact on Americans' pension and 401(k) holdings. This tightening of financial conditions would damage the U.S. recovery and result in slower output growth and less job creation. At a time that U.S. unemployment is very high, this is a particularly unacceptable outcome. In the extreme, U.S. financial markets could become so impaired that this would dry up the flow of credit to households and businesses.

III. U.S. Dollar Swaps

In terms of what actions the official sector in the United States has taken or could take with regard to Europe, I wish to emphasize that any and all such actions pursued by the Federal Reserve are motivated by the mandates Congress has given to the Federal Reserve to promote price stability and maximum sustainable employment here in the United States.

When the Federal Reserve System was created by Congress in 1913, it was given the responsibility of providing liquidity to the financial system in times of stress in order to shield the economy, to the extent possible, from the severe effects of financial instability on economic activity and jobs. While the economy and the markets have evolved substantially in the century since then, this basic principle continues to guide our efforts today. Central banks around the world have an important lender of last resort role. This role is important in order to protect the economy against financial instability.

In today's globally integrated economy, banks headquartered outside of the U.S. play an important role in providing credit and other financial services in the U.S. – providing a total of about $900 billion in overall financing within the U.S. For these banks to provide U.S. dollar loans, they have to maintain access to U.S. dollar funding. At a time when it is already hard enough for American families and firms to get the credit they need, we have a strong interest in making sure that these banks can continue to be active in the U.S. dollar markets.

Banks headquartered outside the U.S., like banks that are headquartered here, make extensive use of dollars in their financing activities. In part, this is due to the fact that the U.S. dollar is the world's number one currency – a status that brings with it many benefits for our country. It is in the U.S. national interest to make sure that non-U.S. banks that are judged to be sound by their central bank are able to access the U.S. dollar funding they need in order to be able to continue to finance their U.S. dollar assets. If the access to dollar funding were severely impaired, this could necessitate the abrupt, forced sales of dollar assets by these banks, which could seriously disrupt U.S. markets and adversely affect U.S. businesses, consumers, and jobs.

One way we can help to support the availability of dollar funding is by engaging in currency swaps with other central banks. This has been used as a policy tool dating back to 1962. Recently, the Federal Open Market Committee decided to re-launch this tool, cooperating with five other central banks. Our intention is to create a credible backstop to – but not supplant – private markets. Banks with surplus dollars are more likely to lend to banks in need of dollars if they know that the borrowing bank will be able to obtain the dollars it needs to repay the loan, if necessary, from its central bank.

This action is designed to support financial stability, avoid an unnecessary tightening in financial conditions, and support economic activity and jobs in the United States. In particular, by reducing the cost of dollar funding via the swap lines last month, we reduced the pressure on banks in Europe to abruptly liquidate their U.S. dollar assets. Thus, this step will help to insulate U.S. markets from the pressures in Europe and support the availability of credit to U.S. households and businesses. European banks are particularly active in areas such as trade finance, project finance, energy lending and municipal finance – a sharp contraction of the financing they provide would be harmful for the U.S. economy as a whole, including for U.S. exporters, firms working on infrastructure projects, the energy industry and hard-pressed state and local governments across the country.

U.S. financial institutions currently do not face difficulty obtaining liquidity in short-term funding markets. However, were conditions to deteriorate, the Federal Reserve has a range of tools available to provide an effective liquidity backstop for such institutions and is prepared to use these tools as needed to support financial stability and to promote the extension of credit to U.S. households and businesses.

In sum, I am hopeful that Europe can effectively address its current fiscal challenges. The Federal Reserve is actively and carefully assessing this situation and the potential impact on the U.S. economy. At this time, although I do not anticipate further efforts by the Federal Reserve to address the potential spillover effects of Europe on the United States, we will continue to monitor the situation closely.

Thank you for your invitation to testify today, and I look forward to your questions.

Mr. MCHENRY. Mr. Kamin.

STATEMENT OF STEVEN B. KAMIN

Mr. KAMIN. Thank you, Chairman McHenry, Ranking Member Quigley, Congressman Cummings, and members of the subcommittee, for inviting me to talk today about the economic situation in Europe and recent actions taken by the Federal Reserve in response to the situation.

The fiscal and financial strains in Europe are spilling over to the United States by restraining our exports, depressing confidence, and adding to pressures on U.S. financial markets. Of note, foreign financial institutions, especially those in Europe, are finding it more difficult to borrow dollars.

These institutions make loans to U.S. households and firms, as well as to borrowers in other countries who use those loans to purchase U.S. goods and services. Thus, difficulties borrowing dollars by European institutions may make it harder for U.S. households and firms to get loans and for U.S. businesses to sell their products abroad. Moreover, these disruptions could spill over into U.S. money markets, raising the cost of funding for U.S. financial institutions.

To address these potential risks to the United States, on November 30th the Federal Reserve announced, jointly with the European Central Bank and the central banks of Canada, Japan, Switzerland, and the United Kingdom, that it would revise, extend, and expand its swap lines with these institutions. The measures were motivated by the need to ease strains in global financial markets which, if left unchecked, could impair the supply of credits to households and businesses in the United States and impede our economic recovery.

Three steps were described in the announcement. First, we reduce the pricing of the dollar swap lines from a spread of 100 basis points over the overnight index swap rate to 50 basis points over that rate. The lower cost enables foreign central banks to reduce the cost of the dollar loans they provide to financial institutions in their jurisdictions. This, in turn, should help alleviate strains in international financial markets and put foreign institutions in a better position to maintain their supply of credit, including to U.S. households and businesses.

Second, we extended the closing date for these lines from August 1, 2012, to February 1, 2013, demonstrating that central banks were prepared to work together for a sustained period, if needed, to support global liquidity conditions.

Third, we agreed to establish swap lines in the currencies of the other participating central banks. These lines would allow the Federal Reserve to draw foreign currencies and provide them to U.S. financial institutions on a secured basis. U.S. financial institutions are not experiencing any foreign currency liquidity pressures at present, but we judged it prudent to make such arrangements should the need arise in the future.

I would like to emphasize that information on the swap lines is fully disclosed on the Web sites of the Federal Reserve Board and the Federal Reserve Bank of New York.

I also want to underscore that the swap transactions are safe and secure. First, the swap transactions present no exchange rate or interest rate risk because the terms of each drawing and repayment are set at the time the draw is initiated. Second, each drawing on the swap line must be approved by the Fed, allowing us to closely monitor use of this facility. Third, the foreign currency held by the Fed during the term of the swap provides an important safeguard.

Fourth, our counterparties are the foreign central banks, not the private institutions to which the central banks lend. The Fed's history of close interaction with these central banks provides a track record justifying a high degree of trust and cooperation. Finally, the short tenor of the swaps means that positions could be wound down relatively quickly were it judged appropriate to do so.

Notably, the Fed has not lost a penny on these swap lines since they were established in 2007. In fact, fees on these swaps have added roughly $6 billion to overall earnings on Fed operations.

To conclude, the changes we have made to our swap line arrangements should help maintain the flow of credit to U.S. households and businesses while protecting the U.S. taxpayer. Ultimately, however, the easing of financial strains here and abroad will require concerted action by the European authorities. We are closely monitoring the events in Europe and the spillovers to the U.S. economy and financial system.

Thank you again for inviting me to appear before you today. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Kamin follows:]

Thank you, Chairman McHenry, Ranking Member Quigley, and members of the Subcommittee for inviting me today to talk about the economic situation in Europe and recent actions taken by the Federal Reserve in response to this situation.

For two years now, the tone of global financial markets has become progressively more entangled with fiscal and financial developments in Europe. The combination of high debt levels and low growth prospects in several European countries using the euro has raised concerns about their fiscal sustainability. Such concerns were initially focused on Greece but have since spread to other euro-area countries, leading to substantial increases in their sovereign borrowing costs. Pessimism about their fiscal situation, in turn, has helped to undermine confidence in the strength of European financial institutions, increasing their cost of raising funds and threatening to curtail their supply of credit. These developments have placed significant strains on global financial markets and have weighed on global economic activity.

Late last week, European leaders announced new steps to address the crisis, including proposals to strengthen fiscal rules and European fiscal coordination, as well as to enhance and provide additional clarity on the timing and design of a more credible euro-area financial backstop. These steps are a positive development and indicate the commitment of European leaders to alleviate the crisis. However, many key details of their proposed policies have yet to be worked out, and implementing them will be a challenge. Hence, it will be critical for European authorities to follow through on their commitments in the days and weeks ahead.

Here at home, the financial stresses in Europe are undoubtedly spilling over to the United States by restraining our exports, helping to push down business and consumer confidence, and adding to pressures on U.S. financial markets and institutions. Of note, foreign financial institutions, especially those in Europe, are finding it more difficult to fund themselves in dollars.

A great deal of trade and investment the world over is financed in dollars, so many foreign financial institutions have heavy borrowing needs in our currency. These institutions also borrow heavily in dollars because they are active in U.S. markets, purchasing government and corporate securities as well as making loans to households and firms. As concerns about the financial system in Europe have mounted, many European banks have faced a rise in the cost and decline in the availability of dollar funding. Difficulty acquiring dollar funding by European and other financial institutions may ultimately make it harder and more costly for U.S. households and businesses to get loans. Moreover, these disruptions could spill over into the market for borrowing and lending in U.S. dollars more generally, raising the cost of funding for U.S. financial institutions. Although the breadth and size of all of these effects on the U.S. economy are difficult to gauge, the situation in Europe poses a significant risk to U.S. economic activity and bears close watching.

Swap Lines with Other Central Banks

To address these potential risks to the United States, the Federal Reserve agreed with the European Central Bank (ECB) and the central banks of Canada, Japan, Switzerland, and the United Kingdom to revise, extend, and expand its swap lines with these institutions.[1] These actions were described in a joint announcement by the Federal Reserve and the other central banks on November 30. The measures were motivated by the need to ease strains in global financial markets, which, if left unchecked, could impair the supply of credit to households and businesses in the United States and impede our economic recovery. At present, such strains are particularly evident in Europe, and these actions were designed to help prevent disruptions in financial markets there from spilling over to the U.S. economy.

[1] See Board of Governors of the Federal Reserve System (2011), "Coordinated Central Bank Action to Address Pressures in Global Money Markets," press release, November 30, www.federalreserve.gov/newsevents/press/monetary/20111130a.htm.

Three steps were described in the November 30 announcement. First, we reduced the pricing of drawings on the dollar liquidity swap lines. The previous pricing had been at a spread of 100 basis points over the overnight index swap rate.[2] We reduced that spread to 50 basis points. The lower cost to the ECB and other foreign central banks will enable them to reduce the cost of the dollar loans they provide to financial institutions in their jurisdictions. Reducing these costs should help alleviate pressures in U.S. money markets generated by foreign financial institutions, strengthen the liquidity positions of European and other foreign institutions, and boost confidence at a time of considerable strains in international financial markets. Through all of these channels, the action should help support the continued supply of credit to U.S. households and businesses.

Second, we extended the authorization for these lines through February 1, 2013. The previous authorization had been through August 1, 2012. This extension demonstrates that central banks are prepared to work together for a sustained period, if needed, to support global liquidity conditions.

Third, we agreed to establish, as a precautionary measure, swap lines in the currencies of the other central banks participating in the announcement. (The Federal Reserve had established similar lines in April 2009, but they were not drawn upon and were allowed to expire in February 2010.) Once such lines are set up, the Federal Reserve could, if needed, activate one or more of these lines and draw foreign currencies. With such access to foreign currency funds, the Federal Reserve could provide euros, Canadian dollars, Japanese yen, Swiss francs, or British pounds to U.S. financial institutions on a secured basis, much as the foreign central banks provide dollars to institutions in their jurisdictions now. U.S. financial institutions are not experiencing any foreign

[2] The dollar overnight index swap rate is the fixed rate that one party agrees to pay in exchange for the average of the overnight federal funds rates over the life of the swap. As such, it is a measure of the average federal funds rate expected over the term of the swap.

currency liquidity pressures at present, but we judged it prudent to make arrangements to offer such liquidity should the need arise in the future.

I would like to emphasize that information on the swap lines is fully disclosed on the Federal Reserve's website--through the weekly balance sheet release and other materials--and information on swap transactions each week is provided on the website of the Federal Reserve Bank of New York.[3]

I also want to underscore that these swap agreements are safe from the perspective of the Federal Reserve and the U.S. taxpayer:

- First, the swap transactions themselves present no exchange rate or interest rate risk to the Fed. Because the terms of each drawing and repayment are set at the time that the draw is initiated, fluctuations in exchange rates and interest rates that may occur while the swap funds are outstanding do not alter the eventual repayments.
- Second, each drawing on the swap line must be approved by the Federal Reserve, which allows the Federal Reserve to monitor use of the facility by the foreign central banks.
- Third, the foreign currency held by the Federal Reserve during the term of the swap provides an important safeguard.
- Fourth, our counterparties in these swap agreements are the foreign central banks. In turn, it is they who lend the dollars they draw from the swap lines to private institutions in their own jurisdictions. The foreign central banks assume the credit

[3] For each week's Federal Reserve balance sheet, see www.federalreserve.gov/releases/h41. For other relevant information and materials on the Federal Reserve's website, see www.federalreserve.gov/monetarypolicy/bst_liquidityswaps.htm. For weekly information on the Federal Reserve's swap transactions with other central banks, see www.newyorkfed.org/markets/fxswap/fxswap.cfm. Finally, for copies of the agreements between the Federal Reserve and other central banks, as well as other information, see www.newyorkfed.org/markets/liquidity_swap.html.

risk associated with lending to these institutions. The Federal Reserve has had long and close relationships with these central banks, and our interactions with them over the years have provided a track record that justifies a high degree of trust and cooperation.

- Finally, the short tenor of the swap drawings, which have maturities of at most three months, also offers some protection, in that positions could be wound down relatively quickly were it judged appropriate to do so.

The Federal Reserve has not lost a penny on any of the swap line transactions since these lines were established in 2007, even during the most intense period of activity at the end of 2008. Moreover, at the maturity of each swap transaction, the Federal Reserve receives the dollars it provided plus a fee. These fees have added roughly $6 billion to overall earnings on Federal Reserve operations over the past five years, thereby increasing the amount the Federal Reserve has returned to taxpayers.

Conclusion

The implementation of the changes in swap arrangements I have discussed has had some positive effects on dollar funding markets. On the announcement of the changes, several measures of the cost of dollar funding declined. Moreover, at the auctions of three-month dollar funding conducted by our foreign central bank counterparties the following week, the amount of dollars provided escalated substantially.

That being said, I would underscore that ultimately, the easing of strains in U.S. and global financial markets will require concerted action on the part of European authorities as they follow through on their announcement last week and take new steps, as needed, to address their fiscal and financial difficulties. The situation in Europe is continuously evolving. Thus, we are closely monitoring events in the region and their spillovers to the U.S. economy and financial system.

Thank you again for inviting me to appear before you today. I would be happy to answer any questions you may have.

Mr. MCHENRY. Thank you, Mr. Kamin.

Mr. Sobel.

STATEMENT OF MARK SOBEL

Mr. SOBEL. Chairman McHenry, Ranking Member Quigley, Congressman Cummings, thank you for this opportunity to discuss interests in European economic reform.

Over the past year, stresses in Europe have spread to some of Europe's largest economies. The crisis now facing Europe is deeper and more entrenched. Euro area growth is projected by most analysts to be negative this quarter and into early 2012. The OECD, which earlier this year projected eurozone growth in 2012 of 2 percent, just revised this estimate to 0.2 percent.

In the United States, the pace of recovery has strengthened, but given strong global linkages, Europe's problems are a serious risk for us. The EU buys nearly 20 percent of U.S. goods exports. When European growth slows, U.S. jobs and exports decline. When European financial markets tighten, U.S. banks may be less willing to lend, hurting American businesses that rely on bank credit to grow. When European stocks decline, U.S. equity markets often do as well, hitting the savings, the 401(k) programs, and wealth of Americans. In States such as New York, North Carolina, and Illinois, over 150,000 jobs, and over 250,000 in Illinois, are export-related.

Europe has an enormous self-interest in tackling its problems. As President Obama and Secretary Geithner have stated, Europe clearly has the capacity and resources to address its crisis. Europe is making progress in putting in place reforms to create the conditions for future growth and build a stronger architecture for fiscal union. The recent European Council agreement represents an important step forward, but more work remains to be done.

Supporting Europe is a matter of vital national interest for the wellbeing of the American economy. Therefore, we are heavily engaged with Europe. Bilaterally, the President is actively engaged. There are extensive contacts with European leaders. Secretary Geithner has traveled to the Europe three times in the last 3 months. Multilaterally, we are working through the G–20. Last month in Cannes, France, G–20 leaders focused heavily on the European crisis. Mexico is going to chair the G–20 in 2012, and promoting a more effective European crisis response is a top priority of the Mexican chair.

The IMF is a central institution of the international monetary system. It has well served the world and the United States. It helped the United Kingdom and Italy overcome crises in the 1970's, resolved the Latin American debt crisis of the 1980's, supported Central and Eastern European transition in the early 1990's, and later that decade and earlier in the last decade responded to Asian and emerging-market crises. It has been a hallmark of my career to see the strong bipartisan support in both the executive and legislative branches for the Fund's role in the global economy.

Countries, first and foremost, bear the burden of adjustment, but the IMF can play a role in promoting more orderly adjustment by offering financing to support economic reforms, thus providing breathing space to countries in overcoming their problems with less disruption. When growth plummets in one country, especially a large country, it spills over on to others. In these circumstances, IMF support helps mitigate the impact on the system as a whole.

The global financial crisis in 2009 offers a good example. The actions taken by national authorities, coupled with the London summit announcement of significant new IMF support, helped stem a massive destabilizing capital outflow from emerging markets. This action was critical in promoting recovery.

The IMF is a good investment for the United States. It helps promote global stability. When the Fund lends, it does so subject to conditions to help assure it is repaid. Its repayment record is outstanding. When the IMF draws on U.S. resources, we are exposed to the Fund's balance sheet, and that balance sheet is solid. The Fund is regarded as the world's preferred creditor, meaning that all IMF members agree it gets repaid first.

The challenge Europe faces is within the capacity of stronger European members to manage. As European countries strengthen economic reforms and fiscal governance, Europe must also continue mobilizing the requisite resources to put in place a strong and credible firewall commensurate with the scale of the challenge. It must do so quickly, with force and determination. The IMF cannot substitute for a strong and credible European firewall in response.

The IMF now has a substantial arsenal of financial resources, almost $400 billion. The administration has been clear with our international partners that we have no intention of seeking additional funding for the IMF.

Thank you for inviting me again today. I look forward to answering any questions.

[The prepared statement of Mr. Sobel follows:]

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Testimony of
Deputy Assistant Secretary Mark Sobel
Before the House Oversight Subcommittee on
TARP, Financial Services and Bailouts of Public and Private Programs
December 16, 2011

Chairman McHenry, Ranking Member Quigley, thank you for this opportunity to discuss U.S. interests in European economic reform.

The European Economic Outlook is Weakening

Over the past year, economic and financial stresses in Europe have spread to some of Europe's largest economies, and the crisis now facing Europe is deeper and more entrenched. Sovereign bond yields have risen sharply in many countries. Many European financial institutions have faced difficulties in obtaining funding from markets and are de-leveraging in order to strengthen their capital adequacy. European equities have fallen by a quarter since April.

These developments have resulted in a sharp weakening in Europe's current growth performance and significant markdowns in growth projections for 2012. Growth in the euro area is projected by most analysts to be negative this quarter and into early 2012, with weak growth persisting in 2012. For example, the OECD, which earlier this year had projected annual average European growth in 2012 of 2.0 percent, just revised its estimate to 0.2 percent. Many private forecasters are more pessimistic.

Europe's problems are a serious risk for the U.S. outlook

In the United States, the pace of recovery has strengthened recently and most analysts expect continued moderate growth next year. But given Europe's strong trade and financial linkages with the rest of the world, other regions could feel the impact as well. Indeed, Europe's problems are a serious risk for the U.S. economic outlook.

- The European Union buys nearly 20 percent of U.S. goods exports ($242.6 billion in 2010) and over 30 percent of U.S. service exports ($170.2 billion). The European Union accounts for 63 percent of the stock of foreign direct investment (FDI) into the United States, at $1.5 trillion, and 56 percent of new investment in 2010. Therefore, when European growth slows, U.S. jobs, exports, and FDI inflows decline.

- Global financial markets are strongly interconnected. When European financial markets tighten, it can adversely impact U.S. banks' confidence and their willingness to lend and invest. That, in turn, can hurt American businesses and jobs, particularly in smaller firms that depend on credit from their banks to grow and innovate.

- When EU stocks decline, U.S. equity markets often do as well, hitting the savings and wealth of Americans.

To make these linkages more concrete, for instance, exports to the European Union represent over 24, 20 and 18 percent, respectively, of merchandise exports from New York, North Carolina, and Illinois. In each of these states, over 150,000 jobs – and over 250,000 in Illinois – are export-related. A decline in exports to Europe will inevitably adversely impact America.

Engaging Europe

First and foremost, Europe has an enormous self-interest in tackling its problems. The events of the last two years have highlighted the need for the currency union to have an adequate crisis response toolkit to respond to economic and financial stress, as well as stronger disciplines to assure long-term fiscal and external sustainability. As President Obama and Secretary Geithner have stated on numerous occasions, Europe clearly has the capacity and the resources to address its crisis.

Europe is making progress in putting in place reforms to create the conditions for future economic growth and to build a stronger architecture for fiscal union. The recent European Council agreement represents an important step forward. But more work remains to be done.

Our ties to Europe are deep and longstanding. The Transatlantic partnership is vital to our national security. Supporting Europe is not just a matter of diplomacy or friendship. Rather, it is a matter of vital national interest for the well being of the American economy, for the wellbeing of American workers, for the wellbeing of American businesses, and for the wellbeing of American families and individuals saving for their future.

Therefore, we are heavily engaged with Europe through bilateral and multilateral channels.

Bilaterally, the President is actively engaged. There are extensive contacts with European leaders. Secretary Geithner has traveled to Europe 3 times in the last 3 months to engage with his counterparts. Over the past two years, we have offered our perspective about the dangers that the sovereign debt crisis poses for the global recovery. And we have shared the lessons from our own financial crisis, including the importance of responding to market challenges decisively and with overwhelming force.

Multilaterally we are working closely with countries around the world to help promote a stronger and more balanced global economy. To do so, we have valuable international fora, particularly the G-20—which is the principal forum for international economic and financial cooperation with membership comprising 85 percent of the global economy—and the International Monetary Fund (IMF or Fund).

Recognizing the strong linkages among their economies, G-20 Leaders underscored at the London Summit in April 2009 their willingness to aggressively tackle and stabilize the global economy and financial system. Together, they undertook a massive and powerful cooperative effort. Later that year in Pittsburgh, with global economic conditions steadying and the recovery underway, Leaders agreed on a Framework for Strong, Sustainable and Balanced Growth that requires actions by all G-20 countries to address the global imbalances that preceded the crisis.

The world's ability to tackle its medium term challenges will require cooperative actions by all, but it surely also requires tackling and overcoming the near term challenges. This, in turn, underscores the significance of an effective European response to the euro area crisis. Last month in Cannes, France, G-20 Leaders focused heavily on the European crisis. The Cannes Summit Communiqué underscored the importance of strengthening European banks, building an effective European firewall to avoid contagion, and laying the foundations for robust economic governance reform in the euro area. Mexico will chair the G-20 in 2012, and it already has stressed that promoting a more effective European crisis response will be a top priority.

The IMF is a central institution of the international monetary system, and international monetary cooperation is as vital today as it was when the IMF was founded over sixty years ago. Throughout this time period, the Fund has served well the global community and U.S. economic interests. It helped Europe and Japan achieve sustained growth in the post-war period. After the demise of the Bretton Woods System, it helped the U.K. and Italy overcome their crises in the 1970s, resolve the Latin American debt crisis of the 1980s, support economic transition in Eastern Europe and the former Soviet Union in the 1990s, and was central to the response to the Asian and emerging market financial crisis late in the 1990s and earlier this decade.

As a civil servant with extensive experience on IMF policy issues, it has been a hallmark of my career to see the strong bipartisan support, in both the executive and legislative branches, for the Fund's role in the global economy. I have seen Secretaries Baker, Brady, Bentsen, Rubin, Summers, O'Neill, Snow, Paulson, and Geithner all stand squarely behind the IMF as it addressed the most critical financial and economic challenges of our times. Through this support, the United States has been able to exercise strong global leadership in responding to crises.

The Fund has not wavered in its belief in the central role of sound economic policies and reforms, but it has responded with flexibility to the needs of countries. Countries first and foremost bear the burden of adjustment. They must put their fiscal houses in order and live within their means. But the Fund can play a role in promoting more orderly adjustment by offering financing to support economic reforms, thereby providing some breathing space to countries in overcoming their problems in ways that are less disruptive.

When growth plummets in one country, especially a large country, it spills over onto others. In these circumstances, the Fund's support also helps mitigate the impact on innocent bystanders and the system as a whole. The global financial crisis in 2009 is a good example. Numerous emerging market economies, including many that had strengthened their performance over the prior decade and were engines of growth for the world economy, were hit by a massive outflow of capital that threatened to undermine their hard-won gains. The actions taken by national authorities in early 2009, coupled in particular with the announcement at the London Summit of new and significant support for the IMF, helped stem the capital outflows and steady the international financial system. This action was pivotal in promoting global recovery.

The IMF is a very good investment for the United States. The Fund helps promote global stability and lessen the fallout from events abroad to American workers and families. When the Fund lends, it does so subject to appropriate conditions and with safeguards to assure it is repaid. And its repayment record is outstanding. When the IMF draws on U.S. resources, the United

States is exposed to the Fund's balance sheet - not the borrowing countries - and the Fund's balance sheet is rock solid. The Fund is regarded as the world's preferred creditor, meaning that the IMF's member countries acknowledge and agree that it gets repaid first.

The Role of the Fund in Europe

The crisis in Europe is severe, and it is impacting not only Europe, but the entire global economy. The challenge Europe faces, however, is completely within the capacity of the stronger European members to manage. As European countries act to develop critical economic reforms and to strengthen fiscal governance, Europe must also continue mobilizing the requisite resources to put in place a strong and credible firewall commensurate with the scale of the challenge. It must do so quickly, with force and determination.

The United States and our international partners stand with European leaders as they move to put in place decisive solutions. The IMF is important in providing external assessments of reform programs which have unparalleled credibility. The IMF cannot substitute for a strong and credible European firewall and response.

The IMF now has a substantial arsenal of financial resources – almost $400 billion. The Administration has been clear with our international partners that we have no intention of seeking additional funding for the IMF.

Conclusion

Our nation's economic recovery and job creation depend on a strong world economy and stable international financial markets. The global economy now faces deep challenges that threaten domestic and global growth and heighten financial instability. Foremost is the situation in Europe. Stresses that harm U.S.-European trade and propagate financial contagion from Europe adversely affect U.S. businesses, slow our recovery, and harm U.S. workers, jobs, and families. Let us work together, with our allies, and through our leadership in international fora and institutions, to overcome these challenges that put our recovery, and the world's, at risk.

Mr. McHENRY. Thank you, Mr. Sobel. And thank you for representing the administration.

I recognize myself for 5 minutes.

Let's begin at sort of a broad question here for the whole panel. Now, the reason why we are having this discussion is because, in the last crisis, policymakers on the Hill were largely caught flat-footed on the actions of the Federal Reserve and the extraordinary actions of the request from Treasury for the creation of TARP. The American people were surprised by it, too.

Looking at this crisis with Europe, I think it is important that we have oversight hearings on the Hill to understand the range of options that you have, both with our central bank and the central bank's, really, main market bank being represented here today, or main market participant, to understand the range of options.

So let's begin with this question. Do you believe that European countries are suffering from a liquidity problem, or is it a solvency problem? And why do you believe that?

Mr. Dudley.

Mr. DUDLEY. Thank you, Chairman McHenry.

I think that if you look at Europe as a whole, Europe has the fiscal capacity to solve their problems. The issue is really a political one rather than an economic one. It is a huge political coordination problem of getting 17 countries that share the euro and 27 countries that are part of the European Union to have a meeting of minds to move toward greater fiscal integration.

We are seeing movement in that direction, but it is not happening, maybe, as fast as some of us might like. But I do not see Europe as having, you know, a fiscal insolvency problem as you look across Europe broadly. Their situation fiscally is, you know, very comparable to ours or other countries.

Mr. KAMIN. So, if I could add on to those remarks, with which I fully agree, essentially, on top of a number of different challenges that Europe faces, it faces a critical problem of confidence—confidence by global investors in the long-term sustainability of fiscal finances in some European countries, although, as President Dudley has mentioned, if you look at Europe as a whole, its fiscal numbers in terms of debt do not seem out of line; confidence in the near-term liquidity situation of European countries. Investors want the confidence they know that countries will be able, and, you know, before the long term is reached, to secure their necessary funding. And then, finally, confidence in the stability of the banking system.

So it is incumbent upon European authorities to address all of these issues, and, indeed, they have taken a number of steps on all three fronts. In the summit announcement that was released last Friday, they, you know, suggested measures to bolster long-term fiscal discipline. They also released additional measures to address the viability of the financial backstop, you know, for euro area countries. And, finally, somewhat previous to that, they announced higher capital requirements for banks.

So they are taking measures, but a lot more follow through is needed on them. Details need to be fleshed out. But, again, the Europeans have a deep commitment to address the issue, and they should have the resources to be able to do so.

Mr. MCHENRY. Thank you.

Mr. Sobel.

Mr. SOBEL. I very much agree with Bill Dudley and Steve Kamin. I would underscore fully the point that Europe has the capacity and the resources to address this challenge.

Mr. MCHENRY. Okay. Thank you.

So it is a liquidity, in essence, it is a liquidity challenge the countries face. I think that is what you are generally saying.

So let me follow up with this. What about European banks? Do they face a liquidity challenge or a solvency challenge?

Mr. Dudley.

Mr. DUDLEY. I think it is hard to generalize across, you know, all the different banks in Europe. I think there are some banks that are in greater degrees of difficulty than others.

The good news I think is that the European authorities are doing the same kind of stress test that we ran here in the United States, and they are identifying the capital needs that their banks have and are basically demanding that their banks raise their capital ratios over the next 6 months or so. So I think that is a very important step to restore confidence in the European banking system.

Now, that is not sufficient. They also have to have confidence in the fiscal sustainability of each country's debt burdens, because the banks hold a lot of sovereign debt.

So you really have to solve two problems. You have to basically make sure the banks have enough capital to, sort of, handle normal stress environments, but you also have to get each country on a sustainable fiscal path so that people are comfortable that the sovereign debt they hold is going to be money good in the end.

Mr. KAMIN. Just to add briefly to those remarks, all of which, again, I agree with, in general whenever you have a liquidity problem, either for sovereign governments or for banks, it is because at least some subset of investors have doubts about the solvency as well, even if perhaps a broader class of investors is more confident.

So that is why it is critical in this situation where liquidity is at issue to bolster confidence and sustainability and long-term solvency. And that is why it is critical that the Europeans move ahead on various fronts, both fiscal discipline, financial backstop, and both increasing the transparency of bank situations as well as ensuring that they have sufficient capital.

Mr. SOBEL. Very briefly, I agree with all that was said, and I guess the only other point I would like to stress is that I think it is very important for European banks to have strong and adequate capital——

Mr. MCHENRY. If you would speak into the microphone. Thank you.

Mr. SOBEL. Sorry. That is important that European banks have strong and adequate capital positions and access to funding.

Mr. MCHENRY. Interesting. Artful answers, I am sure.

But, Mr. Kamin, thank you. I think you answered this question because you at least touched on the fact that are doubts about the solvency of many financial institutions.

Mr. Dudley, would you like to follow up?

Mr. DUDLEY. Yeah, I mean, if I could just add to what Mr. Kamin said, one of the issues is, if investors have even the slightest doubt about the solvency of an institution, even, you know, 1 or 2 percent probability that the institution is insolvent, they are often likely to pull back in terms of their funding.

So the liquidity problem comes about not because the institution is definitively insolvent, but just that there is some risk of insolvency. So liquidity and solvency are related, but you can have a liquidity problem without a bank being insolvent.

Mr. MCHENRY. And you can also have a bank with no liquidity problems that is fully insolvent.

Mr. SOBEL. Well, the, sort of, crisis in the United States is a good example of the latter.

Mr. MCHENRY. Yes. Okay. Thank you so much. My time has fully expired.

Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Yesterday's panel talked about those same issues, but they also mentioned that some of these smaller countries might break off and that, in the end, it could be better for those countries and the situation as a whole for them to do that. Do you agree, as a panel?

Mr. DUDLEY. I don't have an opinion on—I don't feel qualified to offer an opinion as to what is in the best interest of countries. It is for their citizens to decide and their leaders to decide.

Mr. QUIGLEY. Well, not just a political reason, an economic reason—the ability to control their own currency and—an economic answer.

Mr. DUDLEY. You know, the economic answer would be, on one hand, if you were to break away, you could have a currency that depreciated against the euro, and therefore you could regain your trade competitiveness. That is sort of the positive part of the story.

The negative part of the story, which is very negative, is the fact that it would be very difficult for you to honor all your obligations that you have in terms of euro liabilities. And so it would be hugely devastating for any country that left the euro in terms of how their financial system actually was able to perform going forward.

The euro system does not contemplate any country exiting. There is no mechanism to do so. So, you know, we can speculate about what would exactly happen if a country wanted to leave, but we really don't know the answer to that question.

Mr. KAMIN. Just briefly, the eurozone is a long-term project of political unification and economic unification, you know, that dates from World War II. And this is a project that the European authorities still take extremely seriously and are very committed to continuing to perpetuate. So that is why we are—you know, they are very committed to taking the steps needed to pull it together.

To amplify on President Dudley's comments, indeed, while on the one hand if a country or more were, you know, contemplating breaking away, that would give it some more latitude in terms of its exchange rate adjustment. But each of these countries is very tightly linked into the financial system of the rest of the euro area, you know, both in very complex and technical payments, infrastructure ways, as well as a more general web of financial relationships and relations of confidence and trust. So any country contemplating breaking away, you know, could face considerable disruption.

Mr. QUIGLEY. Mr. Sobel.

Mr. SOBEL. Thank you.

Building on Mr. Kamin's remarks, I wanted to underscore his point about the commitment in Europe to the euro. And Europe is moving forward with closer integration, and the institutional underpinnings for the euro area, as Mr. Kamin said, this is a project. But I think it is worth thinking about the following.

Europe has made progress, considerable progress, in this regard. The countries of Europe are undertaking considerable reforms. It is a difficult environment, but if you look at what is happening in Italy and Spain and Portugal and Ireland and Greece, there are major reforms that are being implemented.

Last week, at the European Council meeting, there were major steps made in terms of bolstering the fiscal compact and steps toward a much more rigorous fiscal system for the future. Over the last period, they have created the European Financial Stability Fund and now the European stability mechanism, putting substantial resources at stake.

For me, I think if you thought back 2 years ago, you would have said that these reforms were unimaginable, that Europe would have undertaken them. And yet Europe has responded fairly forcefully. And I just want to underscore that I think it does show the commitment of European leadership to the euro. And I wanted to reemphasize, it is very important that Europe succeed, and it is very important to the United States that Europe succeed.

Mr. QUIGLEY. Thank you.

Mr. Dudley, very quickly, you talked about the loans that we have to countries like Greece, Ireland, Portugal, and Spain being relatively small exposure. I believe the Center for American Progress put that number at about $113 billion. But you did say that to the eurozone as a whole it is a much larger exposure.

I mean, what figure becomes significant, in your mind? I mean, and what happens to the banks in the United States with that $113 billion? I mean, how are they protected at all?

Mr. DUDLEY. I am not familiar with that particular number. I would be—that sounds bigger than what my understanding of the U.S. bank exposures are——

Mr. QUIGLEY. Could someone find out what that number is——

Mr. DUDLEY. We would be happy to get back to you.

Mr. QUIGLEY [continuing]. And report back to us, in terms of Greece, Ireland, Portugal, Spain, and then the rest of the eurozone?

Mr. DUDLEY. But your point is well taken, that as you broaden the exposures out to Europe as a whole, they become very, very large. And what that means is that if the European system were to get into difficulty, there clearly would be consequences for us here in the United States.

Mr. QUIGLEY. Okay. Again, if you could get back to us with a realistic figure for those countries and the eurozone as a whole.

And if anyone—my time has expired, but if anyone could, now or later, sort of explain their understanding of what happens to American banks in that regard.

Mr. DUDLEY. Certainly.

Mr. MCHENRY. Thank you.

The ranking member of the full committee, Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr. Dudley, as I mentioned in my opening statement, you gave a speech at the U.S. Military Academy at West Point during which you indicated that our economy continues to face significant downside risks, mostly related to the stress in the eurozone. Obviously, our hearing today has been called to consider the eurozone crisis, and I appreciate your insights on that issue.

However, you also spoke of another significant downside risk confronting our economy and that is the continuing foreclosure crisis. You even stated that obstacles to mortgage refinancing are so severe that they are undermining the impact of monetary policy.

In your address, you identified a number of measures that might comprise a comprehensive approach to housing policy, including the elimination of barriers to refinancing and measures that will enable borrowers who are underwater on their loans but continue to make their monthly payments to earn accelerated principal reduction over time.

Further, you stated, "I am encouraged by the recent decision by the FHFA to make it easier for certain borrowers with high loan-to-value ratios to refinance." You went on to say, "I hope this initial step will be followed by others that collectively move in the direction of stabilizing house prices. I believe this would not just be good economic policy, but it would also be extremely beneficial for taxpayers, who now effectively own the credit risks of those home loans guaranteed by Fannie Mae and Freddie Mac."

I completely agree with your policy prescriptions. However, when FHFA Acting Director DeMarco appeared before our committee, he testified that he has concluded that the use of principal reduction within the context of a loan modification is not going to be the least-cost approach for the taxpayer. We have asked Mr. DeMarco to provide the details of this analysis, but he has not yet provided us with that information.

These are my questions. Given that, as you said in your statement, taxpayers effectively own credit risks of loans guaranteed by the GSEs, do you believe that enabling borrowers with loans owned or guaranteed by the GSEs who are underwater to earn principal reduction would be in the long-term interest of the taxpayers? That is number one. I want to ask my questions because I want to make sure I get them all in.

Two, we have looked in detail at the FHA refinancing proposal you referenced. And even the FHA estimates that this new program may help, at the most, 900,000 additional borrowers. Is a program that helps 900,000 borrowers adequate to contribute to a stabilization of house prices? Or, do you believe that significantly greater numbers of borrowers need to be helped to yield the stabilization of house prices?

And, finally, how is the failure to stabilize the housing market and help borrowers who are underwater undermining the impact of the monetary policies implemented by the Federal Reserve? And what are the consequences for our economy?

Mr. DUDLEY. Thank you, Congressman Cummings.

Let me take your last question first, how are the problems in the housing sector undermining the effectiveness of monetary policy. It is undermining the effectiveness of the monetary policy because the decline in long-term rates is not being fully taken advantage of by households in terms of their ability to refinance their mortgages. So people have mortgages that are, you know, 5½, 6 percent, 6½ percent who can't refinance because the value of their homes has fallen sufficiently far that their mortgages are now worth more than the value of the home, and so they can't easily refinance. This obviously makes monetary policy less effective because if they could refinance they would get the advantages of those lower mortgage rates, which would put more money in their pocket.

The second thing I would say is, you know, to the extent that you could do some of these things for housing, it has truly two, sort of, benefits. One, if you could stabilize housing prices—if you took these steps, I think you could stabilize housing prices. And if you stabilize housing prices, I think you would actually start to see more demand for housing. And if you saw more demand for housing, then housing prices would start to go up. And that would actually bolster household confidence, because houses are a very large component of the household balance sheet. So if home prices are stable or rising, people are going to feel a little bit better about the outlook not just for housing but also about their own willingness to go out and spend and consume. So we think this would be very favorable for the housing sector.

Now, in terms of your two questions on principal reduction, we think that you can devise a program for homebuyers that have mortgages that are underwater to incent them to continue to pay on those mortgages by giving them some program of principal reduction. Now, obviously, the devil is in the details, so you have to have a good program design. But we are confident that one can design a program which would be net positive to the taxpayer.

In terms of the HARP program that you talked about, the 900,000, you know, obviously, you know, every bit helps. Obviously, I would like to see the program broader so that more households can participate, because that would be helpful in stabilizing the housing sector and it would make monetary policy more effective.

Mr. CUMMINGS. Thank you very much.

Mr. MCHENRY. Mrs. Maloney for 5 minutes.

Mrs. MALONEY. First of all, I would like to welcome Mr. Dudley. New York is so proud of him and his service to our country. And I would like to welcome all of the participants today, and of course my colleagues.

I would like to ask Mr. Dudley, what would be the impact on the U.S. economy and American taxpayers if Europe experiences a deep depression?

Mr. DUDLEY. Well, thank you for the kind words, Congresswoman Maloney.

Obviously, if Europe went into a deep recession, there would be significant consequences to the United States. The first consequence would be in terms of our ability to sell goods and services to Europe. We would have trouble exporting to Europe, and that would have consequences for employment and manufacturing here in the United States.

The second transmission channel would be back to our U.S. banking system. As we have discussed earlier, U.S. banks do have a large exposure to Europe, and so if the European economy is doing very poorly, as you suggest, clearly that would put stress on

U.S. banks' capital and liquidity, and so that could have implications for credit availability here in the United States.

And, third, if Europe were to go into a deep recession, this would also be, I think, quite challenging for financial markets, for the U.S. equity market and for other financial markets. And so that also would have negative consequences to household wealth and to consumer confidence, so I think that would also affect the U.S. economy.

Mrs. MALONEY. Well, some economists are predicting that there will be a breakup of the euro. So I would like to ask Mr. Kamin and Mr. Dudley, how would the breakup of the euro affect the U.S. economy? And do you believe that will happen or won't happen? Starting with Mr. Kamin, then Mr. Dudley.

Mr. KAMIN. Thank you, Congresswoman Maloney.

So, in reference to that and as I said earlier, the European authorities are deeply committed to their project of political and economic unification and deeply committed to the perpetuation of the eurozone, which means, in turn, that they understand the deep seriousness of their current situation and they plan to take the steps needed.

Mrs. MALONEY. Well, then, why aren't they taking the necessary steps to properly combat the crisis? Many economists say they have enough resources to combat it themselves. Do you think they need a TARP-like approach? If they won't combat their own political problem, should we come in and handle their problem for them?

Mr. KAMIN. Well, it is certainly not for us to handle their problems for them. And they are very cognizant of their problems. And they have announced a number of steps in the past week and then in the past few months to address their problem: as announced last Friday, a new set of disciplines on fiscal behavior to raise the confidence of investors in their long-term sustainability——

Mrs. MALONEY. Well, what does their actions bear on the actions that have already been taken by the Treasury and the Fed? And do you support the actions that Treasury and Fed have taken?

Mr. KAMIN. Well, I certainly support the actions of the Fed and Treasury because they pay my salary.

Mrs. MALONEY. Yeah. Team player.

Mr. KAMIN. But I think the way to think of it is, the European authorities have their plate full. They have to do certain things they need in order to stabilize the situation in Europe. Our job——

Mrs. MALONEY. Well, my time is running out, and I would like to also hear from Mr. Dudley. I only have a few seconds left.

So, Mr. Dudley, could you respond?

Mr. DUDLEY. I think I would say two things. One, I——

Mrs. MALONEY. The breakup of the euro, what would that mean to—what would the impact be?

Mr. DUDLEY. Well, this is not something that I anticipate, for the reasons that Mr. Kamin said.

Mrs. MALONEY. Yeah.

Mr. DUDLEY. I think the European leadership is fully committed to the European Union, and they are going to take the steps that they need to move toward greater fiscal integration. As I said earlier, it is a political problem. And so maybe they are not moving as fast as some of us might like, but they are moving, I think, in the right direction.

The second thing I would just stress is, you know, all the things that the Federal Reserve has done with respect to the foreign exchange swaps, this isn't about helping Europe, this is about helping ourselves. This is about ensuring the flow of credit to U.S. households and businesses. We are doing this for ourselves.

Mrs. MALONEY. Okay. My time has expired.

Mr. MCHENRY. I thank my colleague.

Good questions, very good questions. We will begin a second round of questions.

Look, to get into a very specific question following up with Mrs. Maloney, let's say Greece withdraws from the euro. Do you have the scenarios—is that part of the scenarios that you worked through? And would that have—you know, so, walk through that process.

Mr. DUDLEY. Yeah, I don't think that we would characterize that we worked through specific, you know, horrible scenarios surrounding Europe. What we do instead——

Mr. MCHENRY. You don't go through——

Mr. DUDLEY [continuing]. Is do contingency planning to make sure that the Federal Reserve System can handle very stressful environments and ensure that the U.S. banking system can handle very stressful environments, regardless of the source of that stress.

So, for example, the United States right now, we are in the process—the Federal Reserve is right now in the process of putting the U.S. banks through a very severe stress test. And that exercise, which, you know—and that stress might come from Europe, but it could come from some other source. So I think our job is to make sure that the U.S. banks can withstand a bad economic environment regardless of the source of that stress.

Mr. MCHENRY. Okay.

Mr. Sobel, I will begin with you. Play out the scenario for the next 6 months to a year. What does the administration, what does the Treasury, what do they foresee happening with this euro crisis over the next 6 months to a year?

Mr. SOBEL. As I was saying earlier, I think Europe is making progress. They have put in place a number of forms, and they will undoubtedly continue to further move ahead with reforms. Europe is developing its firewall to provide time and space while the countries are putting in place reforms and as these take hold. And we will remain fully engaged and continue to work with them, continue to support them staying on the reform path.

And I think that the Europeans are very closely monitoring the situation. They have talked about having a review of the adequacy of their financial resources and backstopping in March to ensure what I think is important, which is that governments have adequate access to affordable financing and also that banks have adequate funding.

Mr. MCHENRY. So that is your view over the next 6 months to a year?

Mr. SOBEL. I think it is a process and——

Mr. MCHENRY. Okay.

Mr. Kamin, I will ask you the same question. I hope you have a better answer.

Mr. KAMIN. Well, obviously, it is extremely difficult to plot out——

Mr. MCHENRY. That is why I am asking the Federal Reserve. You run through tough scenarios, I understand. But play this out for the next 6 months to a year. What do the American people—what could they expect to see? Give us the range here.

Mr. KAMIN. A great deal depends on how European authorities follow through on the commitments that they have already stated. They have a very full agenda of items that they need to work on. The Friday summit, the last Friday summit involved an EU or intergovernmental agreement among at least the 17 eurozone countries—plus, there are additional countries in the EU but not in the eurozone—to work out, to agree on a system of financial disciplines, to consider a bilateral loan by the Europe to the IMF in order to facilitate their lending, in order to move up the——

Mr. MCHENRY. That is history. So let's go through——

Mr. KAMIN. Those are the items that are on the Europeans' agenda. And so what we look forward to over the next weeks and months is their implementation—their agreement on those items, which will in some cases require ratification by the member states, and their implementation of those.

And that is the process that we are looking forward. And if they move through decisively on that and put these measures in place, there is some chance, perhaps a good chance—it is hard to know—that eventually that will build the confidence needed and we will see the crisis easing. If they do not succeed in the near term in achieving that type of progress and follow through and that disheartens markets and investors, then we can see more adverse outcomes.

But that is basically the framework we are using to look at the next period, is the progress being made by European authorities.

Mr. MCHENRY. Mr. Dudley.

Mr. DUDLEY. I agree with what Steve has said. You know, the devil is now in the details. So we have a broad outline of the way forward, but now we have to actually see the details of how they are going to implement it, and then we have to see the political process support it. And that is really, you know, going to be critical over the next 3 to 6 months.

Mr. MCHENRY. So you are talking structurally. Let's talk about the banks, the European financial institutions.

Mr. DUDLEY. Well, I think that the important thing here to recognize is that if the European countries put their fiscal houses in order, then the banking problems in Europe become much more manageable. Because why investors are worried about European banks is in large part because they are worried about the sovereign debt holdings those banks have. So if the European countries put their fiscal houses in order, this will go a long way to solving the European banking situation.

Mr. MCHENRY. Is that how you see it, Mr. Kamin.

Mr. KAMIN. Very much so.

In addition to that—so that is the critical challenge the European authorities must meet. At the same time, there is a parallel process that will go on for the European banks as they strive to meet their heightened capital requirements. And there are some risks there that have been much talked about in the media about how they will achieve their higher requirements. Will they do it through deleveraging? Will they do it through raising capital? And that is another process that we will be following closely.

Mr. MCHENRY. With that, my time has expired.

Mr. Cummings, the full committee ranking member, is recognized.

Mr. CUMMINGS. Mr. Dudley and Mr. Kamin, the Federal Reserve stepped up a couple of years ago during the U.S. financial crisis and acted as a lender of last resort to the banks. In fact, the Fed played a central role in containing the crisis and stabilizing the American economy.

Why was it important for the central bank of the United States to intervene during the financial crisis?

Mr. DUDLEY. Well, I think during the financial crisis what we saw was a complete loss of confidence in private-sector financial firms to engage with one another. And so it was very, very important for the Federal Reserve to provide a backstop form of funding, so that people were more willing to actually come back into the market and start to engage with one another.

Mr. CUMMINGS. Do you agree with that, Mr. Kamin?

Mr. KAMIN. Absolutely. The problem was basically a breakdown of money markets and, as a result of that, a breakdown in the supply of credit to U.S. households and firms, as well as those around the world. And that posed a dire threat to the global economy and the U.S. economy, and that is why we intervened.

Mr. CUMMINGS. Well, during the 2008 financial crisis, the Fed proactively took steps to prevent panic and acted as the lender of last resort. The United States had and has a long-term fiscal problem, but that did not prevent the Fed from taking action to address the immediate financial crisis at hand.

But the European Central Bank is not doing that in Europe. According to testimony we heard yesterday, the policies that the ECB is pursuing will aggravate the potential for a default. According to Desmond Lachman, "There is the very real risk that continuing to supply substantial fiscal tightening will lead to a very deep economic recession. A deep recession would make it very difficult for countries to reduce their budget deficits and would undermine their political willingness to remain within the euro."

Yesterday, Reuters reported that Ireland's European Affairs Minister, Lucinda Creighton, thinks that the ECB should become a lender of last resort during the European crisis. Do you think that the ECB should let up on austerity and start being a lender of last resort?

I will take the answer from all three of you on that.

Mr. DUDLEY. I think the ECB is being actually quite aggressive in being a lender of last resort to the European banking system. They have now introduced a 3-year—a lending facility where they will provide loans for a 3-year period, which is an unprecedented length of time. They have broadened the collateral eligibility requirements so that it is more easy for European banks to bring collateral to the ECB to get funding.

Where the issue is in Europe, with regard to the European Central Bank, is their ability to buy primary debt issuance from the sovereign countries. And this is prohibited by treaty. It is prohibited by treaty for the ECB to buy the sovereign debt issued by the countries in the primary market. And some people are arguing that they should, sort of, do it anyway, but, you know, Mario Draghi, who is the head of the ECB, points, I think correctly, to the treaty which prohibited such activity.

But I think, in terms of backstopping their banks, they are actually providing a lender-of-last-resort function for the banks.

Mr. KAMIN. I agree with everything President Dudley said, and I would just add a couple of more points.

First of all, in responding to the decline in economic activity that we have seen in Europe in recent months, the ECB has indeed lowered their policy interest rates a couple of times of 25 basis points apiece. So they are taking actions to loosen monetary policy in response to financial and economic strains.

Additionally, while they are indeed, as President Dudley has said, prohibited from buying sovereign bonds directly in the primary market from governments, they are not prohibited from buying bonds in the secondary market—in other words, buying them from other holders of this debt. And, in fact, they have been doing so for some time.

So they are very much committed to indeed acting as a lender of last resort for banks and for supporting the European economy in the ways that they view is within their purview. But a lot of the heavy lifting will have to be done by governments and fiscal authorities, you know, in order to fully address the strains on the system.

Mr. CUMMINGS. Well, Mr. Kamin, do you think that it will be necessary for the ECB to purchase country bonds to stabilize?

Mr. KAMIN. Well, they already are purchasing bonds, as I have said, in the secondary market, and that appears to have been helpful to some degree.

Mr. CUMMINGS. Mr. Sobel.

Mr. SOBEL. Congressman, when one works at the U.S. Treasury, one is trained not to talk about monetary policy by other central banks. So even if I agreed with everything my colleagues have said, I would only say that the ECB has played an important role in ensuring European financial stability, and we look forward to it continuing to do so.

Mr. CUMMINGS. Going back to you, Mr. Kamin, do you think the ECB needs to increase the purchases of the country bonds?

Mr. KAMIN. I think, you know, much depends on both how the economic situation evolves going forward and, in particular, how European authorities follow through on the announcements they have already made. So just as——

Mr. CUMMINGS. But don't you think that would help to avert the crisis—potential crisis?

Mr. KAMIN. Well, I think that, as I say, ultimately, what is required to avert the crisis and get it under control is a very concerted action by European authorities, and certainly a fiscal element has to be critical. The ECB, undoubtedly, will play some role, but what that role will be is not for me, you know, to judge on. But there will have to be some role.

Mr. CUMMINGS. Thank you.

Mr. MCHENRY. I thank the ranking member.

Mr. Gowdy from South Carolina.

Mr. GOWDY. Mr. Chairman, thank you. And I want to thank you for your leadership on this issue, which, frankly, is unparalleled. And while I had a series of questions, including whether or not the breakup of the euro could result in a net devaluation of the resulting bank of basket currencies, as I have sat here for part of this morning and heard your questions I think I am inclined to give you my time so you can more fully——

Mr. MCHENRY. I am inclined to take it.

Mr. GOWDY. And I would like you to more fully develop that and any other ideas that you think are of the moment.

So I would yield to the gentleman from North Carolina.

Mr. MCHENRY. Thank you.

You know, I asked earlier about this notion of what happens with Greece. And I certainly respect the fact that the Federal Reserve doesn't—and the Treasury, you don't want to be out there saying that, you know, you have cooked this into the books, so to speak. You have, sort of, priced in this, and the extension of the swap lines is, sort of, in anticipation of Greece defaulting, whether or not the term "default" is actually used.

You know, there is some notion that what would happen with Greece, with our panel of experts yesterday, is that, you know, Greece would basically, with an ongoing process with other euro participants, have a very significant write-down that is, in essence, a default, but through some other terminology. Therefore, CDS contracts aren't triggered, as we have just seen with this last round.

So let's price this in, okay? Let's say that that process happens. What we have seen is the eurozone put in place policies for Portugal, Spain, and Greece that appear to be failing. So what would it take, what would you suggest it would take, in order for Spain and Italy to not go through those same challenges, based on the existing policy? If those policies aren't quite working with Portugal, Greece, and Ireland, what makes you believe that they would work with Spain and Italy?

Mr. Dudley.

Mr. DUDLEY. Well, first, I am not sure that they aren't working. I think that it is too soon to say exactly whether these countries are going to be able to sustain the fiscal adjustment that they have put in place, and I think the outlook is different for different countries.

The second thing I would say is that the swaps really have nothing to do with whether Greece leaves the euro or not. The swaps were put in place for a very different reason. We were seeing that European banks were having difficulty obtaining dollar funding, and as a consequence of that, they were liquidating their dollar book of assets here in the United States. So this was tightening credit availability in the United States, which was going to have a direct impact, if it was allowed to continue, on U.S. households and businesses.

So the swaps were really about the ability of European banks to obtain dollar funding and the consequences of that on the United States. Whether Greece leaves the euro or doesn't leave the euro, I think that was immaterial to our decisionmaking on the swaps.

Mr. MCHENRY. So the policies in Portugal, Ireland, and Greece you believe are working?

Mr. DUDLEY. I am not going to make an assessment about how well individual countries are doing——

Mr. MCHENRY. Okay, because, you know, their debt-to-GDP ratio is worse now than it was before the policies were put in place.

Mr. DUDLEY. I would say two things.

As you go from the peripheral countries to the core, the debt challenges become much more manageable. In other words, if you look at Spain or you look at Italy and you look at their debt-to-GDP ratio and you look at their deficit-to-GDP ratio, they have to do substantially less than what Greece has had to do.

And so I think that, from my perspective, you know, what Spain and Italy need to do is completely achievable. It is completely achievable. The question is just the political will to implement the fiscal austerity on a reasonable timeframe and convince market participants that they can actually do so.

You know, one of the problems we have right now is that it is going to take time for countries to implement their programs, and therefore it is going to take time for market participants to be convinced that they actually are on a sustainable path. And so the question is, how do you get from here to then when they have actually had a chance to implement their programs?

Mr. MCHENRY. Mr. Kamin, you mentioned money market funds in your testimony. Please expand upon that.

What is the—you know, in the downturn, in the financial crisis, 2008, 2009, the Federal Government stepped in and, in essence, insured—well, directly insured money market funds. So there is a belief among consumers in America that these are protected assets, when, in actuality, they actually are in the market, they have just performed very well over a very long period of time, and only one has broken a buck in, you know, the last generation, we should say.

So, if you will, just expound upon this money market exposure and why these swap lines pertain.

Mr. KAMIN. I would be glad to.

So, first, money market funds, obviously, are an extremely important provider of dollar liquidity, both to U.S. financial markets and financial markets around the world. So many European banks, you know, rely heavily on lending and investing by U.S. money market funds in these bank CDs, commercial paper and the like. And that is an important source of the dollar funding they use in order to provide lending to firms and businesses, both in the United States and abroad.

By the same token, lending to European institutions comprises a large fraction of the U.S. money market funds portfolio. Now, the money market funds have been substantially reducing their exposure to the most vulnerable, so-called peripheral European economies, so that is no longer much of a source of risk. But that said, they still have very substantial exposures to the banks of core European economies.

So in the event that—so that poses a number of risks. First, in the event that the financial strains in Europe were to intensify, money market funds will naturally be expected to further reduce, you know, their exposure to those banks, which would increase their financial straits. And, as well—and this is a problem that has received much attention—you know, U.S. investors in money market funds, you know, might be inclined to take some of their funds out. That could put the money market funds in a difficult situation.

This is something that, of course, we at the Fed and other agencies are very alert to, and that has been an important consideration for the FSOC, you know, Financial Stability Oversight Committee. And they are working on—you know, all regulatory agencies are interested in this. And, of course, the SEC has the primary regulatory authority, you know, for these money market funds, and they are working through some reforms.

Mr. MCHENRY. So the swap line is about direct American exposure in that regard?

Mr. KAMIN. The swap line is about exposure in that regard and many regards. Its point is to make sure, you know, that—to help European and other foreign institutions get the dollar funding that they need in order to continue providing credit, both around the world and to U.S. households and firms. And by doing that, we strengthen the liquidity position of these institutions. And by doing that, we make them appear to be safer investments for money market funds and other investors.

Mr. MCHENRY. Thank you.

Mrs. Maloney.

Mrs. MALONEY. Thank you.

What is the single most important thing that Europe could do to prevent a banking crisis here in the United States? Mr. Sobel, Mr. Kamin, Mr. Dudley.

Mr. SOBEL. Well, let me address the question of what is the single most important thing Europe can do. And I think that it is clear that Europe needs to pursue a comprehensive strategy to overcome the crisis.

This is going to—and what I think needs to be done, in a nutshell, is the countries have to reform, they have to stick to their reform plans. And it is going to be about implementation. It is not going to be easy, but that is a first prerequisite for restoring confidence.

Second, at the European level there needs to be further progress in strengthening the foundations of the eurozone. We saw that with, last week, some steps with regard to the fiscal compact.

And third, as Mr. Dudley was suggesting a minute ago, it takes time for reforms to take hold. So they have to get from here to there. And I think this is where the issue of the European firewall comes into place. It is a firewall that has to be strong and credible, and it needs to be there as a backstop to ensure that countries have access to affordable financing at sustainable rates. And it is important that banks in Europe have adequate capital and access to affordable funding.

Mrs. MALONEY. Mr. Kamin. Mr. Dudley.

Mr. KAMIN. Oh, I very much agree with what Mr. Sobel said. And I guess I would just put it succinctly: There is no single magic bullet. The European authority—you know, what is needed in order to address this crisis is decisive action and follow through by European authorities on all——

Mrs. MALONEY. Do you agree with what the majority's witness, Mr. Lachman, said, that Europe may need a TARP program? Do you agree with his statement?

Mr. KAMIN. I am sorry, but I am not even sure what that might mean, so——

Mrs. MALONEY. Well, I think you know what a TARP program is. Do you think they need a TARP program or not?

Mr. KAMIN. Well, let's put it this way. If by that you mean, sort of, injection by European authorities into the banks of that continent, that represents part, okay, of the agreement that was concluded about a month and a half ago by European authorities that they would raise the capital standards for banks in Europe. And if those were not met, then governments might inject in some form or another.

So I would say that could be—that is already kind of in the cards as part of it. But that by itself is not enough. They have to work on bolstering the fiscal position of the governments.

Mrs. MALONEY. Okay. Thank you.

Mr. Dudley, any comments.

Mr. DUDLEY. I agree with what has been said up to now, Congresswoman.

I think there is a number of steps that have to be taken. You need a clear path of where you are going. You need the European leadership to not waiver in their commitment to unite the eurozone. You need a firewall to allow the countries time to show that you can get there. And you need the countries to do what they have to do in terms of demonstrating that they are committed to getting their fiscal houses in order on a sustainable, long-term basis.

And, last, some of these countries also need to take steps to improve their competitiveness. In other words, they have to do structural reforms to their labor markets, etc., to improve their competitiveness. Because it is not just a fiscal problem; it is also a competitiveness problem for some of these countries.

Mrs. MALONEY. Well, I would like to comment on a strategy that came out of the 2009 G–20, where they agreed to triple the Fund's lending capacity. In response to that, for the IMF, our Congress approved a $108 billion line of credit to the IMF. And some Republicans have come forward with a proposal, or legislation, that would rescind the IMF's authority to spend any of this $108 billion contribution to the IMF's European strategy.

So I would like to ask—let's start with you, Mr. Sobel. Can you explain some of the terms and conditions that are associated with the IMF's financial assistance to the Nation? And what does IMF's assistance really signal to the rest of the world or to other financial backstops to help in this situation?

Mr. SOBEL. Thank you.

In my testimony, I indicated that the IMF funding plays a very vital role in the system in helping countries. When countries face stresses and difficulties, they frequently come to the IMF against the background of a loss of access to financing, which imposes very deep stress on the society and economy as a whole.

What IMF comes in and does is it works with countries to develop a more orderly path to restore growth and vitality. They do so, first, by developing economic conditions. Money is tightly overseen. There are quarterly performance criteria on fiscal and various other indicators to make sure that the country is moving on a track that will restore it to stability. In addition, the Fund provides financing, and that allows the country, as I was saying, to make a more orderly transition toward resumed growth.

Now, that is in the country itself. But when a country has problems, especially a large one, it has ramifications for the neighbors, it can have ramifications for the global economy, as we saw in 2009. And so the logic of IMF assistance is not only to help the country restore stability, but it is also to lessen the impact on the global economy, which is very much in our interest.

And as we indicated earlier, from the vantage point of the United States, one of the problems from a deteriorating situation in Europe is that this hurts U.S. exports, it hurts U.S. growth, it constrains financing to businesses, it hurts our stock markets, our 401(k)'s and the like. So the Fund's support for the global economy can be very vital in helping promote international financial stability.

Mrs. MALONEY. Would the IMF alone be able to fix the crisis, Mr. Kamin?

Mr. KAMIN. I am not sure if I—the Treasury is the main agency here, so I think I will defer to Mr. Sobel, if you don't mind.

Mrs. MALONEY. Yeah. Okay.

Mr. SOBEL. We have said very many times that Europe has the primary responsibility for addressing its problems. It has the capacity and resources to address its problems. We have welcomed the fiscal actions they have taken. We have welcomed the actions they have taken to put in place a stronger governance framework. And we have welcomed the creation of the firewall.

We have been very clear that the IMF cannot substitute for a strong and credible European firewall and a strong and decisive and forceful European response to the crisis.

Mrs. MALONEY. What would happen if the Republican legislation passed that denies the funding from the United States to the IMF?

Mr. SOBEL. So, in my view, the IMF helps serve U.S. interests and—our interest in sustaining global financial stability, which is important to the health of our economy. So, again, Europe has to act. But the IMF can be a tool for helping achieve a sounder world economy, and we want the IMF to have the resources to be able to do its job and perform.

In 2009, Congress approved a $100 billion increase in our commitment to the new arrangements to borrow, as well as a modest $8 billion increase in our quota. And the Fund has long had a backstopping goal for the global economy. I mean, the backstopping role of the Fund through this NAB, the "NAB"—it used to be called something else, the "GAB"—but it goes back to 1962, which is when the swap lines were created, as Bill was mentioning earlier. So this is vital to promoting global stability.

So my view is that, if we were to withdraw our funding, I think it would harm market confidence, I think it would weaken U.S. leadership in the institutions, I think it would put our standing in the Fund in jeopardy, and I think it would cause the Fund to look to others to play a more influential role in its operations and activities. So I think that our support for the IMF is very important.

Mrs. MALONEY. Thank you. My time has expired.

Mr. MCHENRY. Thank you.

And the vice chairman, Mr. Guinta of New Hampshire, is now recognized for 5 minutes.

Mr. GUINTA. Thank you, Mr. Chairman.

Mr. Sobel, when I was here earlier during your opening remarks, I thought I heard you say that the IMF has a very good rate of reimbursement, of repayment. So I wanted you to clarify that for me, and then I wanted to ask you a followup question.

Mr. SOBEL. Thank you.

The IMF, in my perspective, is a very unique institution. So let me just cite three factors.

One, as I was just describing, it can set the macroeconomic conditions for a loan to a country. That helps the country get back to growth, but it also can help ensure that the country gets back to growth through this quarterly monitoring process, and that helps ensure that the Fund's resources are safeguarded.

Second, the Fund is a preferred creditor. So everybody in the world, all countries, all members of the Fund, recognize that the Fund is first in line to be repaid. And its repayment record is just excellent.

Third, it has a strong balance sheet, a very strong balance sheet. It has good reserves. And, again, it has this ability to set these conditions. It has this ability—it has preferred creditor status.

And that is not only good for the members of the Fund, but another dimension of this is that when the IMF draws on our resources and provides it to another country, some people think, you know, you are exposed to that country. In fact, we are exposed to the balance sheet of the Fund. When the Fund draws resources from us, we get a liquid, interest-bearing, and cashable claim on the IMF and its strong balance sheet.

So those were the reasons that I was outlining that I feel that the IMF is—that our claims in the IMF were fully secure.

Mr. GUINTA. The reason I ask is, I believe it was today's Washington Post article, and I don't know if you have seen it yet, but it was entitled, "Will U.S. Taxpayers Be on the Hook for Bailing Out Europe?" There was a quote from Anthony Sanders, who is a professor at George Mason University, who said, "I would expect the $100 billion"—which, I believe, that is a line of credit that we have issued to the IMF—"I would expect the $100 billion to be used and not be paid back," is what he said.

So I am curious about two things: number one, why all of a sudden there would be this shift in an expectation of it not to be paid back, number one; number two, the statements that have been made by Mr. Geithner, followed up by the President of the United States, suggesting that no additional funds should go to the IMF. I am particularly curious to know if that line of credit should be withdrawn, in your opinion.

Mr. SOBEL. First of all, I think that the action taken by Congress in approving the $100 billion NAB line in 2009, which was signed into law shortly thereafter, was a vital step. The announcement of the NAB was instrumental in contributing to strengthening global stability in 2009. It was very visible at the time. And I strongly support—we strongly supported that action.

Again, I am fully——

Mr. GUINTA. You would agree, though, that we are somewhere different today than 2009—or Europe is somewhere different today than they were in 2009?

Mr. SOBEL. Absolutely. I think my point is that we want the Fund to have the resources to do its job. The NAB is part of that, and we strongly back that.

I, again, am firmly of the belief that our claims in the IMF are extremely secure. I think the repayment record of the Fund is stellar. I would be happy to sit with your staff and document that to them.

Mr. GUINTA. Okay. I know that that quote——

Mr. SOBEL. So I just want to say, we will be repaid. And the NAB line—so far, the IMF has drawn $6 billion from our NAB line.

Mr. GUINTA. Let me just get to my—I know that Professor Sanders made that statement yesterday in testimony, so it is something that I would probably want to follow up with you on.

The final question I do have is, in the cases of Greece and Ireland and Portugal, their debt-to-GDP ratio, after receiving assistance packages, I believe actually increased or rose. So, while I understand your point about the impact globally that IMF has, it doesn't seem that countries get the point, that after they receive a loan or a bailout, they are not fixing their debt-to-GDP ratio, which is, quite frankly, the same problem we are having here in the United States, in my view.

So, in a real short amount of time, can you tell me how one would argue that bailouts are even working if that GDP-to-debt ratio is increasing, not decreasing?

Mr. SOBEL. Congressman, I look forward to working with you after this hearing.

So, when growth has slowed in these economies, that has had the effect of depressing revenues. And automatic stabilizers exist in these economies that boost——

Mr. MCHENRY. If you can turn on your mike and pull it to your face, that would be good.

Mr. SOBEL. Okay.

So, basically, this tends to push deficits up in the short term. Meanwhile, these countries are taking actions to bring their fiscal houses in order against the background of the cyclical downturn in the fiscal position.

The point I made is that the IMF support provides a more orderly transition to restoration of growth. And the Fund closely monitors and reviews the performance to make sure the country is getting on track toward a better position.

Mr. GUINTA. Would the chair yield an additional 30 seconds? Thank you, Mr. Chairman.

So what you are saying—I understand what you are saying. You are saying that the debt in the short term is going up, but these countries are taking longer-term measures to stabilize their economy, to improve their economy, have a pro-growth economy, reduce expenditures.

Can you tell me, then, in your opinion, if that is what we think should be a standard, for us to be loaning money to the IMF, are we, in fact, as a nation, imposing that same standard on ourselves? Is the President of the United States imposing that same standard on our country?

Mr. SOBEL. Congressman, I think the—I didn't come here today to——

Mr. GUINTA. Well, there is a tie between Europe and the United States, isn't there?

Mr. SOBEL. I think the President has proposed a bold fiscal plan——

Mr. MCHENRY. If you will please put your microphone toward you. We cannot hear you.

Mr. SOBEL. I think the administration has put forward bold fiscal plans to promote growth and to restore fiscal sustainability and to consolidate the deficit over the medium——

Mr. GUINTA. I would love to have that list. So I am looking forward to working with you, as well. And when we do get together, I would love to see that list.

Thank you, Mr. Chairman.

Mr. MCHENRY. I thank my colleague.

And for the committee's information, we actually requested originally Mr. Sobel's superior at Treasury, who perhaps could have answered that question, in particular, more sufficiently.

One final question. We have votes going on on the floor, and if I could just ask one final set of questions here.

Mr. Dudley, in your written testimony, you said, "If the European situation were to deteriorate further, financial markets would likely become more stressed." And you go through the scenarios for the American economy. Then you say—and this is bold language for the Federal Reserve—"At a time that U.S. unemployment is very, very high, this is a particularly unacceptable outcome. In the extreme, U.S. financial markets would become impaired." And you go forward there. Strong language for the Federal Reserve.

So, in the event of that scenario, that the European situation were to deteriorate further, what is the Fed prepared to do to prevent this outcome?

Mr. DUDLEY. Well, I think my language was really more about how unacceptable the high unemployment rate is and how, if the unemployment rate were to go higher because of events in Europe, that would be very unsatisfactory.

Mr. MCHENRY. To be specific—and my time is limited—I will read you the whole paragraph. And I think that that is not what the written statement says.

Mr. DUDLEY. I will stipulate to your interpretation, just in the interest of time.

I think that, you know, the Federal Reserve is doing what we think is appropriate to support lending here in the United States, and that is why we have engaged with these foreign exchange swaps with the five other central banks.

I don't think we contemplate any other actions, at this time, to do anything else in terms of providing assistance to Europe. It is really their problem to solve, from the Federal Reserve's perspective. The ECB has liquidity facilities in place, in terms of euro currency. They now have swap lines that we think are very sufficient to provide dollar liquidity. So I don't anticipate, even if the crisis in Europe were to worsen, further steps on the part of the Federal Reserve at this time.

Mr. MCHENRY. Mr. Kamin, would the Fed consider purchasing sovereign debt held by U.S. banks to prevent this further deterioration of the European situation?

Mr. KAMIN. I will defer to President Dudley, who is on the Federal Open Market Committee and is the vice chairman——

Mr. MCHENRY. Mr. Dudley.

Mr. DUDLEY. Well, I can't, obviously, speak for my fellow members on the committee, but I think the——

Mr. MCHENRY. Would you consider——

Mr. DUDLEY [continuing]. Bar to doing that would be extraordinarily high. I cannot imagine the circumstances in which we would think that was an appropriate action from a monetary policy perspective.

We have the legal authority to buy foreign sovereign debt, but this is really surrounding our ability to conduct foreign exchange intervention operations. We have a very small portfolio that we run with the Treasury that represents our foreign exchange reserves. And we have never gone out and bought large portions of foreign sovereign debt in the history of the Fed that I am aware of.

Mr. MCHENRY. Okay. Would you consider accepting European sovereign debt as collateral against loans?

Mr. DUDLEY. I think we——

Mr. MCHENRY. Against additional loans.

Mr. DUDLEY. You know, we need to be secured to our satisfaction. And we do take a lot of care in our discount window lending and our other lending to make sure that the collateral that we give is appropriately haircutted and the Federal Reserve is well-protected.

That is one reason why, even despite the large amount of sums that the Federal Reserve disbursed during the financial crisis, we did not lose a penny. We had no credit losses whatsoever. And the Federal Reserve—my understanding is that the Federal Reserve has never had a credit loss.

Mr. MCHENRY. So—excuse me—you would consider it?

Mr. DUDLEY. I wouldn't necessarily rule it out. If the collateral is good collateral and is appropriately haircutted, I don't think I would want to rule that out——

Mr. MCHENRY. Even if it is not Triple A rated?

Mr. DUDLEY. We accept collateral that is non-Triple A rated. So the important point is the quality of the collateral, the appropriateness of the pricing of that collateral, and the appropriate level of haircuts. You know, you do have to have protection in terms of the size of the haircuts, so that is important. But I wouldn't categorically rule that out.

Mr. MCHENRY. Should European banks consider equity raising?

Mr. DUDLEY. You would have to talk to the European banking authorities, but the——

Mr. MCHENRY. Thank you.

Mr. DUDLEY [continuing]. Stress test there did suggest there was a capital need. And equity raising, you know, I think I would be— I think that would be a welcome part of that. Because if they raise more equity, then they have to do less deleveraging.

Mr. MCHENRY. And that would be far preferable.

Mr. DUDLEY. That would be my personal preference.

Mr. MCHENRY. All right.

Mr. Kamin.

Mr. KAMIN. Yeah, I mean, they are already considering equity raising. That is one of the ways in which they could achieve their new higher capital standard, so that is very much in play.

Mr. MCHENRY. All right.

So, with that, you know, I realize your time is very important here. We have votes on the floor. Members have had ample opportunity to ask questions this morning.

This hearing was about proper oversight from Congress of what our political branch at Treasury is doing and to address what is happening in Europe, what we see on the front pages and what raises great concern across this country and around the world.

We also want to see what the range of options are from our central bank. And we realized, with this hearing, that there are an enormous number of questions about this. But we do see that our central bank, both with New York Fed represented here today and the Board of Governors, certainly have looked at the risk associated with this and have a range of plans that they can pursue and a number of policy options that they have. I think that was very clear from today.

What was disappointing is to not see that same level of planning from the Treasury. And I think that would be additional questions that we would have here on the Hill, as to what the Treasury would consider going forward. And we hope to have additional oversight to make sure that we have that disclosed to the public.

So we thank you so much for your testimony. Thank you for your willingness to engage in these discussions. We realize the questions were broad-reaching this morning, but we certainly appreciate your willingness to be here. Thank you for your service to our government and to our people.

And, with that, this committee stands adjourned.

[Whereupon, at 11:17 a.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

The Washington Post

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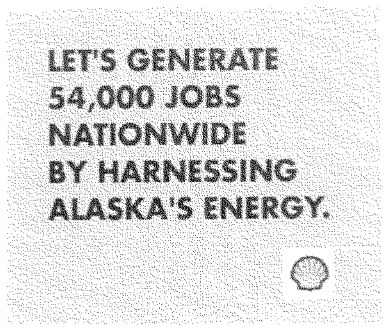

Will U.S. taxpayers be on the hook for bailing out Europe?

By Suzy Khimm, Published: December 15 | Updated: Friday, December 16, 9:00 AM

Congress is finally starting to confront the impact of the debt crisis in Europe on the U.S. And legislators on both left and right are casting a skeptical eye on the U.S.' increasing support for the continent's ailing banks.

"If we learned anything from the last crisis, it is that impromptu precedents by governments increase uncertainty and the likelihood of capital injections on behalf of taxpayers," said Rep. Patrick McHenry (R-N.C.), opening a House hearing on the Euromess on Thursday morning. "The economic risk is real to American taxpayers."

BLOOMBERG

Protesters shout slogans at a demonstration outside the Greek Parliament.

The hearing, held by a House Oversight subcommittee, focused the two major channels through which the United States could support the Eurozone: the Federal Reserve and the International Monetary Fund. As expected, a number of witnesses warned that U.S. taxpayers were likely to carry the burden of a Eurozone bailout through the discounted lending that the Fed recently extended to the European Central Bank through currency swaps, as well as a $100 billion line of credit to the IMF that Congress approved in 2009.

"I would expect the $100 billion to be used and not paid back," said Anthony Sanders, professor at George Mason University, adding that the Fed's lending to "massive socialist states" in Europe could cost taxpayers as well. "The fantasy that they can bail out the pigs — whether it's the pig banks or someone else — is mission impossible."

Similarly, Josh Rosner, managing director of Graham Fisher & Co., warned of the "privatization of gain and socialization of loss" through the Fed's lending to Europe's central bank. "It's not a bailout of populations of Greece, Italy, Hungary ... it is particularly a bailout of banks in core countries of Europe," he said. Rosner also piled on the Fed for making undemocratic decisions "in near darkness without the involvement of our elected officials."

But outside analysts say that it's extremely unlikely that Europe would default on loans from the Fed or the IMF, forcing U.S. taxpayers to eat the losses, even if the Eurozone broke apart. In terms of the Fed's lending, "I don't see that even a worst-case scenario could result in one penny of risk to U.S. taxpayer," said Mark Spindel, founder of Potomac River Capital and former chief investment officer of the World Bank. Even if, say, peripheral countries exited the Euro, the ECB would still be an institution composed of national central banks that can print their own money. "At the end of the day, they have an unlimited capacity to repay their loans, just the way that any central bank works."

What's more, financial analysts point out that the cost of inaction by the Fed carries a price as well. "There would have been greater risk to U.S. taxpayers if the Fed had not done that," said Tu Packard, a senior economist at Moody's Analytics, arguing that European banks have been facing a major credit crunch because of rising interest rates. "They tend to lend to a lot of multinational corporations that have strong dollar requirements."

Greater liquidity through the Fed's lending doesn't solve Europe's underlying solvency and fiscal problems, but it buys the EU more time to attack its fundamental problems, staving off a ripple effect through the markets that could spark another recession in the United States.

Similarly, analysts believe that the U.S.' stake in the IMF also carries relatively little risk, even if the fund were to step up its lending to ailing European governments. The IMF's loans "are the most senior of any debt — they would be paid before anyone else," said Joe Gagnon, senior fellow at the Peterson Institute for International Economics and former official at the Federal Reserve. Gagnon points out that the IMF may also have greater leverage to impose conditions on its lending, with a more independent stance that could force delinquent countries to shape up.

The IMF itself points out that no country has ever defaulted on the loans it has extended, and some see little reason to expect differently in the future.

"I don't imagine we'd see a default to the IMF, and I would just leave it at that. Their undefeated track record will continue," Spindel said.

That said, even proponents of U.S. support of the Eurozone believe that there's little more that we can — or should — be expected to do. "This is really an issue the Europeans have to deal with themselves," said Packard, pointing out that the biggest obstacles to a resolution are still political, not financial.

But as questions of bailouts to Europe have become a political football, Ben Bernanke is trying to reassure anxious members of Congress that the United States won't be on the hook. After Bernanke met with U.S. senators Thursday, Sen. Bob Corker (R-Tenn.), at least, seemed convinced.

"I think people walked away knowing he has no intentions whatsoever of furthering U.S. involvement in the crisis," Corker told reporters.